S&P Global Ratings

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Research Update:

Richmond Housing Partnership 'A+' Rating Affirmed; Outlook Stable

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Overview

- We expect Richmond Housing Partnership (RHP) will retain its focus on its core affordable social housing activities and its current five-year development plan throughout 2023.
- Although profitability will take a hit because of increased spending on fire safety and RHP's exposure to lower-margin shared ownership sales, this will be offset by the group's very strong liquidity position and robust interest coverage.
- We are affirming our 'A+' long-term issuer credit rating on RHP.
- The stable outlook indicates that we expect RHP's management to effectively address the fallout of the COVID-19 pandemic, while maintaining strong liquidity and profitability.

Rating Action

On June 19, 2020, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K.-based social housing provider Richmond Housing Partnership (RHP). The outlook is stable.

We also affirmed our 'A+' issue rating on the £175 million senior secured debt issued by RHP's funding vehicle, RHP Finance PLC.

Rationale

Despite the headwinds caused by the COVID-19 pandemic, we expect RHP to deliver its five-year strategy, focusing on its development program, and to continue to invest in improving customer service and digitization. RHP's use of smart technology and its emphasis on cost savings have helped it build its financial resilience. As a result, it should be able to address the COVID-19 pandemic, as well as the rent cuts and welfare reforms over the past few years, and still maintain a low operating cost per unit.

In our base case, we forecast that S&P Global Ratings-adjusted EBITDA margins will weaken temporarily, averaging 31% over the next two years, before recovering to about 35% in the financial year (FY) ending March 2023. We expect profitability will be strained by increased fire safety upgrade expenditure, the group's exposure to lower-margin shared ownership activities, and a small reduction in the rent collected in FY2021 due to COVID-19.

Our previous base case already incorporated the cost of the fire safety upgrades expected for FY2020, but the pandemic delayed the installation of some of the new sprinkler systems. These investments are now likely to complete in FY2021-FY2022, hampering profitability during this period. Once these upgrades have been completed, we expect margins to normalize around the 35% level. That said, future changes to health and safety regulations could require additional investment and weigh on profitability. The additional costs will be partially offset by the consumer price index (CPI) plus 1% rent settlement that will apply from the current year.

The 'A+' rating is underpinned by the group's focus on low-risk traditional housing activities, very strong asset quality, and highly experienced management team.

We consider that RHP benefits from very high demand for its affordable housing units. In its historical areas of operation (Richmond, Kingston, Hounslow, and Hillingdon) average social rent represents a low 37% of market rent and vacancy rates are relatively low, averaging 1.1% over the past three years. However, the COVID-19 pandemic has hampered rent collection. More than 50% of RHP's tenants are self-funders and do not receive housing benefits; this increases its exposure to the labor market. RHP has therefore suffered a small drop in rent collected this year compared with previous years and we expect its gross arrears position to increase. Nevertheless, we still expect gross arrears to be moderate compared with its London-based peers.

We expect RHP will ramp up development in FY2022-FY2023, in order to reach its goal of delivering 1,000 units by FY2023. Exposure to shared ownership sales is likely to remain below 15% of total revenue and RHP is expected to continue targeting its core boroughs. Our base case assumes some slippage in the delivery of the development program, as completions are delayed by COVID-19-related site closures. It also incorporates our expectation that house prices will decrease and remain depressed over the next two years (see "Government Job Support Will Stem European Housing Market Price Falls," published on May 15, 2020), which will put pressure on the group's operating margins for shared ownership activities. Management still has no appetite for exposure to outright market sales.

We forecast that debt will increase over FY2021-FY2023, but that the group's interest coverage will remain strong. The increase in debt is linked to the group's development ambitions--RHP aims to secure funding 12-24 months before it is needed. We now expect RHP's debt to increase to around £375 million in FY2023. In addition, debt to adjusted EBITDA is predicted to rise to 17x in FY2022, from 11x in FY2020, because profitability is likely to deteriorate more sharply than we had previously forecasted. Adjusted EBITDA interest coverage will remain very solid at about 2.2x on average over FY2021-FY2023. This reflects the group's robust financial policies. During the current year, it has refinanced its legacy facilities to lower its overall interest rate.

Like other English housing associations, it is our view that there is moderately high likelihood that RHP would receive extraordinary support in case of financial distress. That said, this is neutral for our rating on RHP, as there is no uplift from the SACP. RHP'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 RHP 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 track record of being willing and able to provide extraordinary support on a timely basis.

Liquidity

We assess RHP's liquidity position as very strong. We expect sources of liquidity to exceed planned uses by around 2.2x over the next 12 months. The development program to which RHP is committed is fully funded in advance of RHP's needs. We view RHP'S access to external liquidity as satisfactory.

We forecast liquidity sources will comprise:

- Forecast cash generated from continuing operation: £20 million;
- Cash and liquid investments: £7 million;
- Proceeds from asset sales: £1 million;
- The undrawn, available portion of committed bank facilities or bank lines maturing beyond the next 12 months that can be drawn: £45 million;
- Proceeds from the deferred issuance of its retained bond: £40 million; and
- Expected ongoing cash injections from a government: £3 million.

We forecast uses of liquidity will comprise:

- Expected capital expenditure: £43 million; and
- Interest: £9 million.

Outlook

The stable outlook indicates that we expect RHP will manage the fallout from COVID-19 adequately, so that adjusted EBITDA margins remain above 30% and liquidity coverage remains very strong. We assume that RHP will retain its focus on its core affordable housing activity as it delivers its development plan throughout 2023, such that steadily increasing earnings support rising debt to fund the program.

Downside scenario

We could lower the ratings on RHP if we observed a deterioration in its financial performance, so that adjusted EBITDA margins structurally fall below 30%, owing to weakening control over its cost base or deteriorating margins on its shared ownership activities. Under such a scenario, we would likely observe a worsening of the liquidity position and increased volatility in the business through higher exposure to development-for-sale activities.

Upside scenario

Conversely, we could raise the ratings if RHP improved its financial performance such that adjusted EBITDA margins structurally exceed 40%, and leverage fell structurally below 10x.

Key Statistics

Table 1

Richmond Housing Partnership Ltd. Selected Financial Indicators

	--Year ended March 31--				
(Mil. £)	2019a	2020e	2021bc	2022bc	2023bc
Number of units owned or managed	10,407	10,478	10,553	10,709	10,880
Revenue§	57.9	57.1	62.3	65.4	66.6
Share of revenue from sales activities (%)	4.6	4.5	10.3	10.8	8.6
EBITDA§†	22.1	21.0	19.8	19.6	23.4
EBITDA/revenue §†(%)	38.2	36.7	31.7	30.0	35.1
Capital expense†	37.8	31.3	36.8	76.2	63.1
Debt	224.3	230.3	269.8	334.8	374.8
Debt/EBITDA §†(x)	10.1	11.0	13.7	17.1	16.0
Interest expense*	9.3	9.3	8.3	9.6	10.9
EBITDA/interest coverage§†* (x)	2.4	2.2	2.4	2.0	2.1
Cash and liquid assets	10.5	6.6	9.5	13.8	7.5

§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.

Ratings Score Snapshot

Table 2

Richmond Housing Partnership Ltd.

Industry Risk	2
Economic fundamentals and market dependencies	1
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 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: 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

Related Research

- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 24, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 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
- Global Social Housing Ratings Score Snapshot: December 2019, Dec. 2, 2019
- Global Social Housing Risk Indicators: December 2019, Dec. 2, 2019

Ratings List

Ratings Affirmed	
Richmond Housing Partnership	
Issuer Credit Rating	A+/Stable/--
RHP Finance PLC	
Senior Secured	A+