S&P Global
Ratings

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Research Update:

# U.K. Social Housing Provider Plymouth Community Homes 'A+' Rating Affirmed; Outlook Stable

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## Overview

- U.K.-based Plymouth Community Homes Ltd. (PCH) continues to invest heavily in major repairs and fire risk assessment measures that weigh on its financial performance and debt metrics.
- However, we expect PCH to maintain its very strong liquidity and a low debt burden over our forecast period through fiscal year (FY) ending March 31, 2023.
- We are therefore affirming our 'A+' long-term issuer credit rating on PCH.
- The stable outlook indicates that we expect PCH's financial performance to remain solid with limited reliance on open market sales while maintaining strong liquidity and a low debt burden.

## Rating Action

On Jan. 21, 2021, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K.-based social housing provider Plymouth Community Homes Ltd. (PCH). The outlook is stable.

## Rationale

The affirmation reflects our view that PCH's underlying social housing continues to generate stable earnings that, along with grant funding, will enable the association to continue its modernization and development program. We project that FY2021 results will stabilize following the COVID-19 pandemic's impact, since the development program is 80% committed and borrowing needs remain low.

As for other English housing associations, we believe there is a moderately high likelihood that PCH would receive extraordinary support in case of financial distress. This provides a one-notch uplift from the stand-alone credit profile (SACP). PCH'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 PCH 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.

We view PCH's business profile as strong. This primarily reflects our view of the industry in which PCH operates as low risk, given solid demand for social housing assets and ongoing support from the government through the regulatory framework.

PCH shows strong economic fundamentals as demonstrated by social rent set at 52% of market rent, which is lower than the national average of 59% and further supported by a robust waitlist of 13,000. While this translated into 8% operating margins (FY2020) on its social and affordable housing units, which is below peers, expenses per unit continue to improve through operational efficiencies and the implementation of new technology. PCH monitors its carbon footprint in line with the Streamlined Energy and Carbon Reporting (SECR) framework and has installed solar panels on approximately 2,400 of its homes.

PCH was established in 2009 as a large-scale voluntary transfer from Plymouth City Council (PCC). About 15,000 homes were transferred to PCH, and since then, the housing association has focused on improving the condition of its stock. PCH has invested significantly in works and repairs, which has boosted the overall satisfactory asset quality and the very low vacancy rates of the properties, which have remained below 1% of net rental income over the past five years. However, gross arrears have trended upward, having recently crossed 6% of rental and service charge income. In combination with the higher number of tenants on universal credit benefits, this may contribute to sustained elevated levels of gross arrears over the near term. PCH has, however, set aside adequate reserves, and current tenant arrears remain below 1.5%.

PCH is gradually moving its development program toward more market-related activities, but we expect the share of sales revenue to remain below 15% in the next three fiscal years (2021-2023) in line with PCH's "golden rule" set-up. We understand that in response to the pandemic, the updated five-year business plan (2020-2025) increased emphasis on rented homes from 48% to 57% while reducing open market sales from 21% to 9%, and increased the number of units to 200 from 100, which roughly translates to 220 units per year by FY2023 comprising 125 affordable, 75 shared ownership, and 20 open market sales.

PCH's financial performance has deteriorated since our last forecast and remains weaker than peers; we now forecast S&P Global Ratings-adjusted EBITDA margins to remain below 20% throughout FY2021-FY2023. This is because PCH will have to support one-off costs of tower block upgrades and complete the final phase of its North Prospect regeneration scheme. During FY2020, PCH's expenditure was affected by one-time digital and IT investments that have enabled better remote working capabilities, and provided customers with a new service platform. During the first lockdown, PCH furloughed employees, reduced nonemergency repairs, and closed its unprofitable manufacturing subsidiary to achieve cost savings. As a result, we expect PCH's margins to increase gradually, and to demonstrate comparatively low leverage in our base-case period. We anticipate that debt-to-EBITDA ratios will average around 11x over the rating horizon, compared with 7x in our previous base case. While we expect the increase in development will require more investment, we believe PCH has sufficient funding to complete its five-year strategy and that it will maintain low leverage until 2023.

Despite the deterioration in the debt-to-EBITDA ratio, we consider PCH's debt profile to be very strong, thanks in particular to low funding costs. PCH has taken advantage of the low interest rate environment and increased its variable rate exposure to 25%, which is at the upper bounds of its treasury policy and includes private placements and term loans. We understand that the group plans to fund most of its business plan through development grants with additional funding needed in FY2023 under our base-case scenario. Furthermore, we positively factor in the U.K. central government's funding, secured in 2018, to complete work on tower blocks with defective cladding. To date, this funding has provided 80% of the cost, with the remaining funds expected in FY2022, despite work completing by March 2021.

## Liquidity

PCH's liquidity remains one of the strongest in our rated portfolio. We anticipate that sources of funding will cover uses around 3.04x in the next 12 months on the back of funding secured to cover tower block upgrades.

Sources of liquidity include:

- About £18 million of cash flow from operations;
- About £26 million of cash and liquid investments;
- About £55 million of undrawn committed lines that mature after 12 months;
- About £5 million of U.K. central government funding; and
- About £2 million of proceeds from asset sales.

Uses of liquidity include:

- About £31 million of capital expenditure (capex); and
- About £4 million of interest payments.

We view PCH's access to external liquidity as satisfactory, given its ready access to bank funding, but we consider its track record of issuance in the capital markets to be limited. PCH has access to bond aggregators having borrowed £30 million from The Housing Finance Corp. Ltd. (THFC; A/Stable/A-1) and is also a shareholder of MORhomes PLC (A-/Negative/A-2).

## Outlook

The stable outlook reflects our view that PCH's weak financial performance in FY2020 is temporary and that it will improve over FY2021-FY2023, with stabilizing leverage and robust liquidity underpinned by adequate government funding secured to address fire safety at high rises.

### Downside scenario

Pressure on the ratings could arise were PCH to largely debt-fund the expansion of a development-for-sale program or experience significant increases in capital repair requirements substantially beyond our base case. This would likely affect the group's financial performance, and hence its debt service coverage, as well as our assessment of its financial policies and capabilities of management.

### Upside scenario

An upgrade would, in our view, mainly depend on PCH's ability to successfully implement its future development and modernization plans while raising EBITDA margins toward 30%, all else being equal. If delivered on time and under budget, these improvements could have a positive impact on our assessment of strategy and management.

## Key Statistics

Table 1

### Plymouth Community Homes. Key Statistics

| | --Year ended March 31-- | | | | |
|---|---|---|---|---|---|
| (Mil. £) | 2019a | 2020a | 2021bc | 2022bc | 2023bc |
| Number of units owned or managed | 15,961 | 16,033 | 16,061 | 16,219 | 16,351 |
| Revenue§ | 75.0 | 75.5 | 70.6 | 77.5 | 82.7 |
| Share of revenue from sales activities (%) | 9.4 | 7.5 | 5.6 | 9.3 | 12.1 |
| EBITDA§† | 16.0 | 7.5 | 10.2 | 13.5 | 16.1 |
| EBITDA/revenue §†(%) | 21.3 | 10.0 | 14.5 | 17.4 | 19.5 |
| Capital expense† | 22.5 | 19.8 | 26.6 | 32.5 | 41.3 |
| Debt | 112.0 | 127.5 | 130.5 | 138.5 | 149.5 |
| Debt/EBITDA §†(x) | 7.0 | 16.9 | 12.7 | 10.2 | 9.3 |
| Interest expense* | 3.4 | 3.4 | 3.6 | 3.8 | 4.0 |
| EBITDA/interest coverage§†* (x) | 4.7 | 2.2 | 2.8 | 3.6 | 4.0 |
| Cash and liquid assets | 13.4 | 24.0 | 16.5 | 16.3 | 17.2 |

*Including capitalized interest. §Adjusted for grant amortization. †Adjusted for capitalized repairs. 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

### Plymouth Community Homes Ltd. Ratings Score Snapshot

| | |
|---|---|
| Industry risk | 2 |
| Economic fundamentals and market dependencies | 3 |
| Strategy and management | 3 |
| Asset quality and operational performance | 1 |
| Enterprise profile | 3 |
| Financial performance | 5 |
| Debt profile | 2 |
| Liquidity | 2 |
| Financial policies | 3 |
| 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: 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 Score Snapshot: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Risk Indicators: 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
- 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

## Ratings List

| **Ratings Affirmed** | |
|---|---|
| **Plymouth Community Homes Ltd** | |
| Issuer Credit Rating | A+/Stable/-- |