S&P Global
Ratings

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Research Update:

U.K.-Based Social Housing Association Futures Housing Group Ltd. 'A+' Rating Affirmed; Outlook Stable

October 12, 2020

Overview

- U.K.-based Futures Housing Group's (FHG's) strong and increasing focus on core traditional activities supports our view that the group will maintain EBITDA margins above 30% amid the economic impact of the COVID-19 pandemic.
- The high quality of stock, strong operational performance, and conservative management practices also support the rating.
- We are affirming our 'A+' long-term issuer credit rating on FHG.
- The stable outlook reflects our expectation that FHG will maintain EBITDA margins above 30%, supporting robust debt metrics and sustaining its very strong liquidity position.

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Rating Action

On Oct. 12, 2020, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on FHG. The outlook is stable.

At the same time, we affirmed our 'A+' issue rating on the £200 million bond issued in February 2019 by Futures Treasury PLC, the group's funding vehicle set up for the sole purpose of issuing bonds and lending the proceeds to FHG.

Rationale

The rating on FHG indicates its very strong and increasing focus on core traditional activities, high asset quality, and conservative risk management practices. The rating is also supported by S&P Global Ratings-adjusted EBITDA margins above 30% that result in robust debt metrics and a very strong liquidity position.

In our view, the social housing sector has low industry risk because it benefits from low cyclicality and market volatility. FHG's strong and increasing focus on social housing activities supports our view of the group as a traditional social housing provider. The group has scaled down its development for shared ownership and outright sales, and we therefore forecast that exposure to market activities will steadily reduce, reaching 3% of total revenue by fiscal year (FY) ending March 31, 2023, from the reported 14% in FY2020.

FHG is based in Derbyshire and operates throughout the East Midlands, owning and managing over 10,000 units. We believe demand for social housing in its area of operations--mainly Derbyshire--remains steady, with vacancy rates averaging about 1.1% over the past three years. However, East Midlands has weaker economic fundamentals than most other regions in England. As such, the gap between average social housing rent to market rent is relatively high, at around 30%.

We assess asset quality of the group as high. FHG has robust operational efficiency, as demonstrated by the low level of gross arrears that we estimate at 3% as of March 2020. While we expect that arrears could increase because of the COVID-19-induced lockdown, the group is in a very strong starting position, so we do not expect arrears to weaken our view of its operational performance.

In our view, the group's management is experienced and stable with the right skills to deliver on its strategy. We view the governance and risk management standards as good and suitable for the organization and its operating environment. For instance, the strategy has adjusted to reduce market exposure given uncertainties ahead and despite having robust margins on these activities.

The economic contraction triggered by the pandemic has increased unemployment levels, and as a result, we expect housing associations to suffer losses in rent collections from tenants who do not receive housing benefits. For FHG, we anticipate lower revenue for FY2021 which, coupled with increasing capitalized repairs, will temporarily slightly reduce its EBITDA margin close to 33%. We expect the group to gradually recover and to post increasing margins reaching 37% by FY2023, despite increasing capitalized repairs as the group's strategy continues focusing on investment in its existing stock.

FHG's robust performance combined with stable debt support our expectations that debt to adjusted EBITDA will remain well below 20x and average interest coverage at about 2x in the next 2 years. In June 2020, Futures accessed the markets for issuing its £50 million retained bond. The group achieved a low yield of 1.74%; about half of the yield of the 2019 bond issuance of £150 million. Since the group holds enough cash and liquidity facilities to finance its development program, we do not expect debt to increase during our forecast period. Hampering our view of FHG's debt position is the high loan-to-value ratio, which we estimate at above 70%.

As for other English housing associations, we think there is a moderately high likelihood that FHG would receive extraordinary support in case of financial distress. However, the final rating does not incorporate any uplift from the stand-alone credit profile (SACP) which we assess at 'a+'. FHG'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 FHG 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.

Liquidity

Our assessment of Futures' very strong liquidity position is based on its very high cash levels, substantial amount of undrawn bank lines, and satisfactory access to capital markets. In our base case over the next 12 months, we estimate sources of about £122 million will cover uses by 2.8x.

Sources of liquidity include:

- Adjusted EBITDA used as cash flow proxy of £19 million;
- Cash and liquidity investments of £54 million;
- Proceeds from asset sales of £1 million;
- Undrawn committed facilities of £43 million; and
- Expected ongoing cash injections from the government and other miscellaneous receipts of £5 million.

Uses of liquidity include:

- Expected capital expenditure of £32 million; and
- Interest and principal repayment of £12 million.

Outlook

The stable outlook reflects our expectation that FHG will maintain EBITDA margins above 30% in the next two years, supporting robust debt metrics and sustaining its very strong liquidity position.

Downside scenario

The rating could come under pressure if FHG structurally changes its development strategy, with increasing exposure to sales revenue representing more than 15% of total turnover over the next two years. This would signal an increase in risk appetite, hampering our view of the management, and would likely result in weaker financial metrics.

Upside scenario

We could raise the rating if FHG consistently strengthened its performance with EBITDA margins over 40%, resulting in a debt to EBITDA to below 10x and interest coverage over 2.5x.

Key Statistics

Table 1

Futures Housing Group Key Statistics

	--Year ended March 31--				
(Mil. £)	**2019a**	**2020e**	**2021bc**	**2022bc**	**2023bc**
Number of units owned or managed	10,208	10,254	10,476	10,799	11,000
Revenue§	50.0	57.1	55.9	57.2	58.0
Share of revenue from sales activities (%)	8.3	14.2	10.2	6.2	2.7
EBITDA§†	19.9	19.1	18.2	19.8	21.5
EBITDA/revenue §†(%)	39.8	33.5	32.5	34.6	37.0

Table 1

Futures Housing Group Key Statistics (cont.)

	--Year ended March 31--				
(Mil. £)	2019a	2020e	2021bc	2022bc	2023bc
Capital expense†	79.4	33.0	31.8	32.6	32.6
Debt	218.5	257.0	266.8	266.8	264.2
Debt/EBITDA §†(x)	11.0	13.4	14.7	13.5	12.3
Interest expense*	8.7	9.0	10.6	10.4	10.3
EBITDA/interest coverage§†* (x)	2.3	2.1	1.7	1.9	2.1
Cash and liquid assets	31.8	54.4	62.7	42.4	19.8

*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

Futures Housing Group Ratings Score Snapshot

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Strategy and management	3
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	3
Debt profile	4
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: 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: Principles Of Credit Ratings, Feb. 16, 2011

- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020
- 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	
Futures Housing Group	
Issuer Credit Rating	A+/Stable/--
Futures Treasury PLC	
Senior Secured	A+