Research Update:

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

October 13, 2021

PRIMARY CREDIT ANALYST

Abril A Canizares
London
+ 44 20 7176 0161
abril.canizares@spglobal.com

SECONDARY CONTACT

Karin Erlander
London
+ 44 20 7176 3584
karin.erlander@spglobal.com

Overview

- U.K.-based Futures Housing Group's (FHG's) conservative management practices and highly predictable revenue stream from rental activities support the rating.
- The group's financial position still has enough headroom to cope with additional investments in existing stock while developing new homes.
- We are affirming our 'A+' long-term issuer credit rating on FHG.
- The stable outlook reflects our expectation that a robust and conservative strategy will enable the group to maintain EBITDA margins above 30%, supporting robust debt metrics and sustaining its very strong liquidity position.

Rating Action

On Oct. 13, 2021, 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.

Outlook

The stable outlook reflects our expectation that the group's robust and conservative strategy will enable it to maintain EBITDA margins above 30%, supporting its debt metrics and sustaining its very strong liquidity position.

Downside scenario

The rating could come under pressure if the group tightens its currently available financial headroom by ramping up investments in existing stock significantly above our current forecast, alongside increasing its development of new stock. This would signal a sudden shift of strategy that would likely result in weaker financial metrics and hamper our view of management.

Upside scenario

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

Rationale

The rating on FHG indicates its conservative strategy with a strong focus on core traditional activities and robust financial metrics. The rating is also supported by our expectation that FHG will maintain S&P Global Ratings-adjusted EBITDA margins above 30% even when investments in existing stock are set to increase. FHG maintains a very strong liquidity position, underpinned by the group's large cash position, undrawn facilities, and solid interest coverage.

FHG has kept a conservative approach to market activities. We expect revenues from First Tranche Shared Ownership Sales to be contained at a low 9% of total revenues in the next two years. This supports our expectation of a highly predictable revenue stream, reflecting our view of industry risk in the social housing sector as low given that it benefits from low cyclicality and market volatility.

FHG is based in Derbyshire and operates throughout the East Midlands, owning and managing over 10,000 units. While we estimate that the gap between average social housing rent to market rent in this area of operations is relatively high, at around 70%, we believe demand for social housing, mainly in Derbyshire, remains steady. Vacancy rates have averaged about 1.3% over the past three years despite slightly increasing during the pandemic due to lockdown-related higher re-letting times.

In our view, the group's management is experienced and stable with the right skills to deliver on a conservative strategy that maintains low exposure to risky activities. We view its governance and risk management standards as good and suitable for the organization and its operating environment. We note as well that the group follows robust financial policies that have resulted in solid interest cover.

We expect the group's profitability to remain predictable over the forecast period supported by a regime that allows rents to increase 1% above the consumer price index (CPI), which will counterbalance increasing investments in existing stock. Therefore, we expect that the group will maintain EBITDA margins above 30% through our forecast period with enough buffer to accommodate a 20% increase in capitalized repairs in fiscal 2024.

Taking advantage of currently favorable market conditions, the group is planning to increase its already high cash buffers by accessing funding of £70 million this fiscal year. This will enable it to pre-fund upcoming maturities in FY2024 and to commit to development schemes for achieving its target to deliver 300 units per year. Therefore, we expect debt to increase temporarily in FY2022, to over 20x our forecasted non-sales adjusted EBITDA, but to reduce over the following years reaching around 15x in FY2024. This is because we do not anticipate any further funding needs as long as the group maintains its current development program. We expect average interest coverage from core rental revenues at about 1.6x in the next two years.

We assess the regulatory framework under which registered providers of social housing in England operate as strong, underpinned by their public policy mandate to provide affordable homes. We also consider that the sector benefits from solid ongoing oversight by the Regulator for

Social Housing (RSH). These strengths are offset, in our view, by the relatively low levels of grant funding that the providers in England receive for the development of affordable homes. We consider that providers in England can develop homes for outright sale, using the proceeds as an alternative funding source, however, we think that this exposes them to risks and potential volatility compared with providers in other regions. Providers in England are also subject to negative intervention from the U.K. government in the form of constraints on rent setting or additional spending responsibilities, without adequate additional funding. In our view, this weighs on our regulatory framework assessment.

We believe there is a moderately high likelihood that FHG would receive extraordinary support from the government via the RSH in case of financial distress. However, the final rating does not incorporate any uplift from the stand-alone credit profile, which we assess at 'a+'. As one of the key goals of the RSH is to maintain lender confidence and low funding costs across the sector, we believe the RSH would likely step in to try to prevent a default in the sector. The RSH has a record of mediating mergers or arranging liquidity support from other registered providers in cases of financial distress, and we think this would apply to FHG.

Liquidity

Our assessment of FHG's very strong liquidity position is based on its very high cash levels, substantial undrawn bank lines, and satisfactory access to capital markets. In our base case over the next 12 months, we estimate sources of about £121 million will cover uses by 2.7x.

However, the ramp up of capital expenditure particularly in FY2023 would require more funding and we would expect the liquidity ratio to trend down slightly.

Sources of liquidity include:

- Cash and liquidity investments of £53 million;
- Cash flow from operations adjusted for noncash cost of sale: £23 million
- Proceeds from asset sales of £1.3 million;
- Undrawn committed facilities of £42 million; and
- Expected ongoing cash injections from the government and other miscellaneous receipts of £3 million.

Uses of liquidity include:

- Expected capital expenditure of £32 million; and
- Interest and principal repayment of £13 million.

Key Statistics

Table 1

Futures Housing Group--Key Statistics

	--Year ended March 31--				
Mil. £	2020a	2021a	2022e	2023bc	2024bc
Number of units owned or managed	10,254	10,315	10,621	10,919	11,138
Adjusted operating revenue	57.1	61.3	56.0	60.6	58.8

Table 1

Futures Housing Group--Key Statistics (cont.)

	--Year ended March 31--				
Mil. £	2020a	2021a	2022e	2023bc	2024bc
Adjusted EBITDA	19.1	18.6	16.7	19.5	18.9
Non-sales adjusted EBITDA	17.9	17.4	16.0	18.8	18.9
Capital expense	27.5	23.5	41.5	28.4	41.1
Debt	257.0	267.7	337.7	335.0	308.9
Interest expense	9.0	10.4	11.6	12.7	11.9
Adjusted EBITDA/Adjusted operating revenue (%)	33.5	30.4	29.8	32.1	32.2
Debt/Non-sales adjusted EBITDA (x)	14.4	15.4	21.1	17.8	16.4
Non-sales adjusted EBITDA/interest coverage(x)	2.0	1.7	1.4	1.5	1.6

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

	Assessment
Enterprise risk profile	2
Industry risk	2
Regulatory framework	3
Market dependencies	3
Management and Governance	2
Financial risk profile	3
Financial performance	3
Debt profile	4
Liquidity	2

S&P Global Ratings bases its ratings on non-profit social housing providers on the seven main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on June 1, 2021, summarizes how the seven factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, June 1, 2021
- General Criteria: Group Rating Methodology, July 1, 2019

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- 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 Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 23, 2021
- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021
- 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
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020

Ratings List

Ratings Affirmed	
Futures Housing Group	
Issuer Credit Rating	A+/Stable/--
Futures Treasury PLC	
Senior Secured	A+