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Ratings

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Research Update:

Places for People Group Rating Lowered To 'A-' On Increased Exposure To Market Sales; Outlook Now Stable

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Overview

- From 2019, Places for People group (PfP) will expand its market sales, which we consider riskier than traditional social housing activity, resulting in more volatile and therefore lower quality earnings.
- We believe this exposure will reduce the group's financial capacity to withstand downside risk and weaken its very strong liquidity position.
- We are therefore lowering our long-term issuer credit rating on PfP to 'A-' from 'A'.
- The stable outlook reflects our view that the steady underlying social housing business will continue to mitigate the risks from PfP's diversified business activities.

Rating Action

On June 20, 2018, S&P Global Ratings lowered its foreign and local currency long-term issuer credit ratings on U.K.-based Places for People Group Limited (PfP) to 'A-' from 'A'. The outlook is stable.

At the same time, and in line with the group rating, we lowered the long-term issuer credit rating on Places for People Treasury to 'A-' from 'A'. The outlook is stable.

We also lowered to 'A-' from 'A' the issue ratings on the £400 million bond due 2026; the A$150 million debt due 2022; HK$350 million due 2023; and the £1.5 billion senior unsecured medium-term note program issued by Places for People Treasury. We lowered to 'A-' from 'A' the rating on the £100 million notes due 2038 and £380 million due 2043, issued by Places for People Homes.

Rationale

The downgrade reflects our view that PfP's enlarged development appetite--demonstrated mainly by the increase in homes it is building for sale--and diversified business services stretch its financial risk position and reduce the headroom to withstand downside risk. They also weaken what we still consider to be a very strong liquidity position, supported by strong access to the capital markets.

On the other hand, PfP's substantial social housing business operates in a low risk industry, is well managed, and continues to yield strong financial performance, with operating margins consistently above 40%. We also view the group's coverage of interest payments from social housing lettings, and the extraordinary support it would receive from the U.K. government in case of need as supportive factors.

Our assessment of the moderately high likelihood of extraordinary support is based on PfP's social housing business, which plays an important role in the government's public policy mandate. It also considers the link between PfP and the U.K. government, via the Regulator of Social Housing, to be strong. Therefore, we factor one notch of uplift in the rating above PfP's stand-alone credit profile (SACP) of 'bbb+'.

As a national registered provider of social housing, PfP owns more than 90,000 homes across the U.K. This includes retirement and care homes, affordable and private rent, development for sale, and shared ownership. In March 2018, the group integrated Luminous Association, increasing affordable housing units by over 6,000. Demand for PfP's core operations--that is, submarket homes--is supported by annual population growth of about 0.7%; social rents comprise about 62% of market rents in PfP's area of operations, leading to very low vacancy rates.

That said, its non-social housing activities--such as leisure, property management, building, and construction--operate at much thinner margins, which weighs on the group's consolidated financial metrics. For example, the leisure business contributes about 22% to total turnover but only about 5%-6% to the operating surplus. This results in weaker financial performance, with EBITDA margins of about 22%-25%, remaining below peers. However, we consider this part of the group's business as low risk, with minimal capital investment or debt needs.

Conversely, PfP's credit risk will increase, with its exposure to development for sale expected to reach a steady 30% of revenues in our base case from the financial years ending March 31, 2019 (FY2019) to FY2021. We expect PfP to build nearly housing 6,200 units by 2021, nearly half of which we believe will be sold (including shared ownership first-tranche, and open-market sales). Therefore, we project income from sales of about £110 million in FY2018 will increase threefold by FY2020. This elevates the group's risk profile due to higher debt, lower operating margins in market sales, and more cyclical revenues.

PfP group has high debt of about £2.5 billion (14x debt/EBITDA), but we forecast that its earnings will increase faster than debt in the coming years. Therefore, we believe debt to EBITDA will fall to a moderate 11x-12x by FY2021 unless there is a change in the development program or debt increases faster due to acquisitions. On a core social housing basis, the debt-to-social-housing operating surplus is 18x-20x, which is higher than peers. We incorporate PfP's high loan-to-value ratio (at cost) of slightly above 80% in both our debt assessment and financial policies. Conversely, we view coverage of interest payments from social housing lettings as a strength that somewhat mitigates risk from property market cyclicality.

We view PfP's financial policies as more aggressive and risk tolerance slightly above peers'. This view incorporates PfP's exposure to derivatives (cross-currency swaps that could be subject to cash collateral calls), high debt burden relative to core earnings, and large unsecured debt proportion. Currently, 53% of its debt portfolio is on an unsecured basis, which we understand the group aims to increase to 60% in the medium term. PfP has prudent treasury management, conducted at the group level, and the group board maintains oversight on derivative transactions.

Liquidity

We consider that PfP has a very strong liquidity position thanks to its high cash levels, undrawn bank lines, and strong access to capital markets. In our base case over the next 12 months, we estimate sources of cash of about £734 million will cover uses of about £512 million by about 1.4x.

Liquidity sources include:

- Current cash of around £193 million;
- Cash from operations of about £218 million;
- Capital grants of about £28 million; and
- Undrawn contractually committed facilities expiring beyond 12 months of £305 million.

Liquidity uses include:

- Capital expenditure on repairs and new development of about £305 million;
- Debt service (including interest costs) of about £207 million; and
- Net asset purchase outflows of about £10 million.

Outlook

The stable outlook reflects our view that the steady underlying social housing business will continue to cover PfP's interest expenditure, and sales risk will remain contained at around 30% of total revenues.

We could lower the rating on PfP if we believe that the risk in the fundamental business has heightened. This could occur if management is unable to respond to external pressure, extends its focus further from the core social housing business, or further increases its exposure to riskier market sales.

We could also lower the rating if we believe the likelihood of support from the U.K. government will not extend to the whole group in a timely manner, particularly considering the large non-social housing business streams at PfP.

We could raise the rating if we believe there is marked sustained reduction in exposure to market sales, and at the same time PfP's financial performance within the social housing business is maintained. An upgrade would also be contingent on PfP's loan-to-value reducing to sustainably below 70% and interest coverage improving materially.

Key Statistics

Places for People Group Ltd. Selected Financial Indicators

	--Year ended March 31--				
(Mil. £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
Number of unites owned or managed	182,725.0	198,752.0	201,935.0	203,025.0	204,100.0
Vacancy rates (% of rent net of identifiable service charge)	1.0	1.0	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)*	2.3	2.3	N.A.	N.A.	N.A.
Revenue§	779.8	736.7	871.5	1,073.8	1,036.4
Share of revenue from nontraditional activities (%)	64.1	55.9	58.3	65.8	62.8
EBITDA†	177.1	183.1	212.3	249.1	266.9
EBITDA/revenue (%)	22.7	24.9	24.4	23.2	25.8
Interest expense	114.3	125.6	126.2	131.8	132.3
Debt/EBITDA (x)	14.1	13.9	12.4	11.2	10.5
EBITDA/interest coverage** (x)	1.5	1.5	1.7	1.9	2.0
Capital expense	112.1	211.8	250.6	221.0	158.9
Debt	2,499.7	2,551.3	2,629.2	2,779.7	2,791.9
Housing properties (according to balance sheet valuation)	2,866.3	3,015.1	3,264.7	3,475.0	3,591.9
Loan to value of properties (%)	87.2	84.6	80.5	80.0	77.7
Cash and liquid assets	184.8	163.8	50.0	50.0	84.8

*Rent and service charge arrears. §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.

Rating Score Snapshot

Places for People Group Ltd. Ratings Score Snapshot

Industry Risk	2
Economic fundamentals and market dependencies	4
Strategy and management	3
Asset quality and operational performance	1
Enterprise profile	3
Financial performance	5
Debt profile	4
Liquidity	2

Places for People Group Ltd. Ratings Score Snapshot (cont.)	
Financial policies	4
Financial profile	4

S&P Global Ratings' analysis of social housing providers' creditworthiness rests on our scoring of eight key rating factors: (i) industry risk; (ii) economic fundamentals and market dependencies; (iii) strategy and management; (iv) asset quality; (v) financial performance; (vi) debt profile; (vii) liquidity; and (viii) financial policies. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published Dec. 17, 2014, and "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015, detail how we derive and combine the scores, and then determine each social housing provider's stand-alone credit profile and the issuer credit rating. In accordance with S&P Global Ratings'public and nonprofit social housing providers methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating, the committee can make use of the flexibility afforded by paragraphs 12-17 of "Methodology For Rating Public And Nonprofit Social Housing Providers."

Related Criteria

- General Criteria: Guarantee Criteria, Oct. 21, 2016
- 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: Group Rating Methodology, Nov. 19, 2013
- 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

- Default, Transition, and Recovery: 2017 Annual International Public Finance Default Study And Rating Transitions, June 11 2018
- Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 27, 2018
- U.K. Social Housing Providers To Borrow £12 Billion Of New Debt By 2020 Total Debt to Reach £89 Billion, March 7, 2018
- New Rent Policy Brings Relief, But No Big Boost To The Credit Standing Of U.K. Housing Associations, Jan. 31, 2018
- Global Social Housing Risk Indicators – January 2018, Jan. 30, 2018
- U.K. Social Housing Scenario Analysis: What Could Happen To Ratings In A Market Downturn? Sept. 25, 2017

Ratings List

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Downgraded; Outlook Action
                                        To                  From
Places for People Group Ltd.
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Places For People Treasury PLC		
Issuer Credit Rating	A-/Stable/--	A/Negative/--
Places For People Treasury PLC		
Senior Unsecured	A-	A
Senior Unsecured (1)	A-	A
Places for People Homes Ltd.		
Senior Secured	A-	A
Senior Unsecured	A-	A

(1) Dependent Participant: Places for People Homes Ltd.

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.