S&P Global
Ratings

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Research Update:

U.K.-Based Metropolitan Thames Valley Housing 'A-' Ratings Affirmed; Outlook Remains Negative

December 21, 2022

Rating Action Overview

- U.K.-based housing association Metropolitan Thames Valley Housing (MTVH) continues to scale back the development of new homes, leading to a reduction in the group's exposure to sales risk.
- However, we understand this is partially driven by the need to make investments in existing stock to remediate fire and building safety risks and make the homes more energy efficient.
- In combination with inflationary cost pressures, we project this will result in continued pressure on MTVH's S&P Global Ratings adjusted EBITDA, which in turn affects the group's adjusted EBITDA margins and debt metrics.
- We affirmed our 'A-' long-term issuer credit rating on MTVH. The outlook remains negative.

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Rating Action

On Dec. 21, 2022, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on MTVH. The outlook remains negative.

We also affirmed our 'A-' long-term issuer credit rating and maintained a negative outlook on Metropolitan Housing Trust Ltd. (MHT), which we consider a core subsidiary of MTVH, since it owns and manages the majority of the group's rental units and shared ownership sales. We also affirmed our 'A-' rating on MHT's £2 billion senior secured and unsecured medium term notes program and the £250 million senior secured bond.

At the same time, we affirmed our issue rating on Metropolitan Funding PLC's £250 million senior secured bond at 'A-'. Metropolitan Funding PLC was set up for the sole purpose of issuing bonds and lending the proceeds to the group, and we view it as a core subsidiary of MTVH as well.

Outlook

The negative outlook reflects that on the U.K., as well as the possibility of a weakening of MTVH's financials. We think that higher-than-anticipated inflation combined with the group's ambitious program of investments in existing homes, especially on fire and building safety, could weaken financials well beyond our current expectations.

Downside scenario

We could lower the rating on MTVH in the next two years if the group's adjusted EBITDA decreased such that the adjusted EBITDA margins and adjusted nonsales adjusted EBITDA interest cover weaken to about 15% and 0.75x on a sustained basis, respectively. We could also lower the rating if we were to lower our sovereign credit rating on the U.K., or if we revised downward our view of the likelihood of extraordinary support to MTVH from the U.K. government in the event of financial distress.

Upside scenario

We could revise the outlook to stable if the group's nonsales adjusted EBITDA interest cover remains close to 1x with EBITDA margins performing in line with our base-case expectations. A stable outlook would also depend on the outlook on the sovereign rating on the U.K. having been revised to stable.

Rationale

The rating on MTVH reflects our view that the group's operations in the countercyclical social housing sector in affluent areas of England support strong demand for its homes and services. We consider positively that the group has been gradually scaling back its development program, in particular the development of units for sales. We understand that the reduction in development is mainly driven by the need to accommodate for cost-inflation pressures and higher investments in existing stock, especially relating to fire, and building safety in the coming few years. Under our base case, we expect these costs, compounded by a significantly lower than inflation rent increase in the current year, and the cap on rent increase of 7% next year, will continue to pressure the group's adjusted EBITDA. We consider that this is likely to impair the group's adjusted EBITDA margins as well as its debt metrics.

MTVH's affordability levels in its main areas of operations and large stock support our view of its creditworthiness. The group owns and manages a large stock of about 57,000 units, and we consider that its size and geographic footprint in the U.K. allow it to build up economies of scale in its operations. MTVH's operations are mainly in and around London, which benefits from stronger economic conditions than the national average. On average, we assume the group's social and affordable rent levels are fairly low, at about 50% of the prevailing market rents. We are mindful that the group's void levels have increased over the last two years, but remain broadly in line with the sector's average of 1.5% of rent receivable and service charges.

We assess the regulatory framework under which registered providers of social housing in England operate as strong (for more information see "Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers," published June 8, 2021).

We note that MTVH's management has gradually reduced its risk appetite over the past few years. We expect the group's sales exposure will be mainly contained to first-tranche sales of shared ownership units, while open market sales will be delivered through joint ventures (JVs). We therefore project the group's revenues from sales activities, including those from JVs, will be contained below one-third of its total adjusted operating revenues over the coming years.

We consider that MTVH's management remains focused on delivering on its identified operational and financial targets to ensure financial sustainability. We understand the reduction in the group's sales exposure reflects a general scaling back in its development program. This signals, in our view, a balanced strategy between the delivery of new units and the need to make investments to improve the quality of the existing asset base. Nonetheless, we think that the group's risk appetite is elevated, and flexibility is constrained, due to fairly modest financial metrics.

We expect inflationary pressures and increased investments in existing stock will weaken adjusted EBITDA margins compared with our previous forecast, but that they will remain roughly 20% over the next three years. We expect performance will be temporarily stronger in the fiscal year ending March 2023, thanks to a fairly large capital contribution for some of the works on existing properties.

We expect cost pressures and rising interest rates will squeeze the group's debt metrics, despite slower than previously forecast debt build-up. While MTVH will receive capital grant funding from Homes England and the Greater London Authority, as well as proceeds from the sale of fixed assets, we expect debt to remain the main funding source of new development. We estimate that 87% of MTVH's current debt is at fixed rates, somewhat mitigating the effect of rising interest rates in the short term.

We believe there is a moderately high likelihood that MTVH would receive timely extraordinary government related support in case of financial distress. This provides two notches of uplift from the stand-alone credit profile (SACP). As one of the key goals of the Regulator of Social Housing (RSH) is to maintain lender confidence and low funding costs across the sector, we believe it is likely that the RSH would step in to try and prevent a default in the sector. We base this view on previous records of the RSH mediating mergers or arranging liquidity support from other registered providers in cases of financial distress, and think this would also apply to MTVH.

Liquidity

We view MTVH's liquidity as very strong. We expect the group's sources of liquidity to exceed planned uses by about 1.8x over the next 12 months, mainly supported by its very large undrawn bank facilities. We view MTVH's access to external liquidity as satisfactory.

We expect liquidity sources will comprise:

- Cash flow from operations, adding back noncash cost of sales, of close to £125 million;
- Current cash and liquid investments of £80 million;
- Proceeds from asset sales of about £120 million;
- The undrawn, available portion of committed facilities of close to £570 million; and
- Other inflows, including government grants receipts, dividends from--and return of investments in--JVs, of about £30 million.

We forecast uses of liquidity will comprise:

- Expected adjusted capex of about £300 million;
- Interest and principal payable of close to £170 million; and
- Other outflows of close to £34 million.

Table 1

Metropolitan Thames Valley Housing--Key Statistics

	--Year ended March 31--				
Mil. £	**2021a**	**2022a**	**2023bc**	**2024bc**	**2025bc**
Number of units owned or managed	58,063	57,184	57,207	57,132	57,278
Adjusted operating revenue	439.6	408.1	399.4	425.4	457.3
Adjusted EBITDA	104.5	81.2	91.4	88.0	97.7
Non-sales adjusted EBITDA	92.6	71.9	85.1	78.7	93.0
Capital expense	126.2	147.7	275.4	315.8	348.4
Debt	1,965	1,905	2,003	2,118	2,294
Interest expense	82.9	76.6	85.0	91.0	98.0
Adjusted EBITDA/Adjusted operating revenue (%)	23.8	19.9	22.9	20.7	21.4
Debt/Nonsales adjusted EBITDA (x)	21.2	26.5	23.5	26.9	24.7
Nonsales adjusted EBITDA/interest coverage(x)	1.1	0.9	1.0	0.9	0.9

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

Metropolitan Thames Valley Housing--Ratings Score Snapshot

	Assessment
Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	2
Management and Governance	3
Financial risk profile	4
Financial performance	4
Debt profile	6
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

- U.K. Social Housing Providers Set Their Sights On Cyber Risks, Dec. 16, 2022
- Non-U.S. Social Housing Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022
- Inflation To Erode The Performance Of U.K. Public Finance Sectors, Nov. 29, 2022
- Cap On Rent Increases Is Consistent With Our Base case For English Social Housing Providers, Nov. 17, 2022
- United Kingdom, Oct. 24, 2022
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 2022
- Economic Outlook U.K. Q4 2022: Under The Pump, Oct. 3, 2022
- United Kingdom Outlook Revised To Negative On Rising Fiscal Risks; 'AA/A-1+' Ratings Affirmed, Sept. 30, 2022
- Launch Of Rent Cap Consultation Adds Uncertainty To Creditworthiness Across English Housing Sector, Sept. 1, 2022
- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022
- Non-U.S. Social Housing Providers Ratings Risk Indicators: July 2022, July 27, 2022
- Non-U.S. Social Housing Providers Ratings History: July 2022, July 27, 2022
- Non-U.S. Social Housing Providers Ratings Score Snapshot: July 2022, July 27, 2022
- U.K. Social Housing Sector Borrowing Needs to Rise To Fund Investment In New Homes, March 31, 2022
- Global Regulatory Framework Report Card: Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings List

Ratings Affirmed	
Metropolitan Thames Valley	
Metropolitan Housing Trust Ltd.	
Issuer Credit Rating	A-/Negative/--

Ratings Affirmed	
Metropolitan Funding PLC	
Senior Secured	A-
Metropolitan Housing Trust Ltd.	
Senior Secured	A-