Research Update:

# U.K. Housing Association The Guinness Partnership Downgraded To 'A-' On Weaker Debt Profile; Outlook Stable

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## Overview

- The Guinness Partnership's (Guinness) new draft financial plan incorporates fewer sales than last year's, while maintaining the housing provider's increased levels of investment in existing assets.
- Consequently, we forecast Guinness will generate lower levels of cash, which weighs on its EBITDA interest coverage.
- We are therefore lowering our long-term issuer credit rating on Guinness to 'A-' from 'A'.
- The stable outlook reflects our view that Guinness will successfully execute its investment in new and existing homes while managing its debt service obligations.

## Rating Action

On Jan. 27, 2020, S&P Global Ratings lowered its long-term issuer credit rating on U.K. social housing provider The Guinness Partnership (Guinness) to 'A-' from 'A'. The outlook is stable.

We also lowered to 'A-' the long-term issue rating on Guinness' senior secured debt of £250 million due 2044 and £100 million due 2037.

## Rationale

The downgrade reflects our expectation that Guinness' decision to reduce its exposure to sales while increasing investment in existing assets, will put pressure on its EBITDA interest coverage. As a result, we forecast S&P Global Ratings-adjusted EBITDA interest cover to fall to just 1x in the financial year ending March 31, 2020 (FY2020), before increasing slightly to 1.1x in FY2021.

Guinness' decision to overhaul its development program leads us to revise our assessment of its industry risk. Previously, we had expected Guinness to generate 40% of its total revenue from sales-related activities. However, based on Guinness' revised plan, we now forecast sales exposure to average just 12% of total revenue, peaking at 18% in FY2022. We therefore think Guinness' operations are less cyclical and more predictable than before.

Our 'A-' rating on Guinness is one notch higher than its stand-alone credit profile. We base this differential on our opinion that there is a moderately high likelihood that the U.K. government--working through the Regulator of Social Housing--will provide timely and sufficient extraordinary support to Guinness in the event of financial distress. In accordance with our criteria for government-related entities, we base our view of the likelihood of extraordinary government support on Guinness' important role for the U.K. government and its public-policy mandate, and its strong and durable link with the U.K. government. The U.K. government has a track record of providing extraordinary support to the social housing sector.

As a nationwide provider of social housing with a strong presence in the northwest and south of England, Guinness boasts a large portfolio, owning and managing almost 65,000 homes in FY2019. We believe Guinness will continue to rationalize its stock when the opportunity arises, similar to its transfer of housing stock to another association in 2018.

At present, Guinness has just 10% of its portfolio in London, with a large percentage remaining in the northwest. Therefore, Guinness' economic fundamentals are slightly weaker than other London-based peers, since Guinness' nationwide reach means that it covers an economically wider range of regions, including less dynamic areas.

Guinness' asset base remains a rating strength. Its average age of stock is 29 years and it has exceptionally low vacancy rates (0.7% in FY2019), which is impressive considering the size of its portfolio. Guinness is managing its gross arrears well: these fell to 5.4% of rent and service charge receivable in FY2019, from 5.7% in FY2018. We expect these operational metrics to remain strong, supported by Guinness' capital investment program, in which we expect capitalized repairs to nearly double in FY2020. We acknowledge that a large proportion of these costs are rising in anticipation of higher and more stringent building safety standards following the review into the Grenfell Tower fire. According to Guinness, investments in existing homes have been relatively stable in recent years. Our opinion is that the sharp increase in spend going forward impacts a number of housing associations, including Guinness, that have properties with particular attributes..

Guinness' draft financial plan points to a substantial lowering of development targets. Its previous plan aimed at developing 20,000 homes over 10 years. Guinness is now aiming for the completion of 12,000 to 13,000 homes over this period. In our opinion, this significant change to the development plan--reflects a less consistent long-term strategic planning than we had previously anticipated. We acknowledge this is driven largely by a strategic shift toward additional investment in existing homes, and changing market conditions.

Guinness' decision to reduce the level of sales in its development program should strengthen its adjusted EBITDA margins in our base case. Factoring in the increase in capitalized repairs, we expect EBITDA margins to average between 20% and 25%.

We assume that Guinness will require grant funding and debt to build the revised target of about 6,000 homes over the next five years. Debt stood at £1.2 billion in FY2019. Factoring in the receipt of about £150 million of grant funding, we expect Guinness to increase debt by slightly more than £200 million by FY2022.

Although the lower level of sales reduces the level of poorer quality earnings, it also reduces Guinness' adjusted EBITDA levels. Under our base case, we estimate that Guinness will complete

120 units for outright sale and about 980 first-tranche shared ownership sales by FY2022, of which 20 and 200, respectively, in the current year to March 2020. Subsequently, we forecast a reduction in EBITDA--adjusted for capitalized repairs and amortized grants--of £32 million over this period. Consequently, we expect Guinness' EBITDA interest cover to deteriorate to just 1x in FY2020, before improving to 1.2x by FY2022.

However, in terms of EBITDA that Guinness generates exclusively through lettings, the provider will marginally cover its interest by 1x per year until FY2022. Debt to EBITDA will also increase rapidly to nearly 19x in FY2020, from 10x in FY2018. We now view Guinness' debt profile, and accompanying debt management policies, as weaker than we had previously.

### Liquidity

Guinness continues to demonstrate a very strong liquidity position owing to its high levels of undrawn facilities of more than £550 million. We expect liquidity sources should sufficiently cover uses by 2.4x over the next 12 months.

Sources of liquidity include:

- Adjusted EBITDA as a cash flow proxy: £82 million
- Cash and liquid investments: £35 million
- Fixed asset sales: £6 million
- Undrawn facilities: £563 million
- Government grants: £38 million

Uses of liquidity include:

- Capital expenditure: £202 million
- Interest and principal repayment: £96 million

We view Guinness' access to external liquidity as satisfactory.

## Outlook

The stable outlook reflects our view that Guinness will successfully complete its new levels of development and investment while managing its cost base such that EBITDA interest cover does not structurally fall below 1x.

### Downside scenario

We could lower the ratings if costs were to rise amid the rollout of Guinness' capital investment plan, reducing its earnings and subsequently eroding its interest cover. In such a scenario, we could also see a weakening in liquidity, since Guinness uses sources to offset the erosion in earnings.

We could also lower the rating if we thought the likelihood of timely extraordinary support from the U.K. government to Guinness had decreased.

### Upside scenario

Alternatively, we could raise the ratings if we saw a structural strengthening in financial performance, which would also support an improving debt profile. This would be supported by adjusted EBITDA margins strengthening above 30% and EBITDA covering interest payments by 1.5x.

## Key Statistics

Table 1

### The Guinness Partnership Key Statistics

| | --Year ended March 31-- | | | | |
|---|---|---|---|---|---|
| **(Mil. £)** | **2018a** | **2019a** | **2020e** | **2021bc** | **2022bc** |
| Number of units owned or managed | 66,779 | 64,944 | 65,245 | 65,696 | 66,454 |
| Revenue* | 359.3 | 346.6 | 344.5 | 377.7 | 425.0 |
| Share of revenue from sales activities (%) | 10.1 | 9.8 | 11.3 | 16.1 | 22.4 |
| EBITDA*§ | 120.5 | 101.6 | 71.1 | 86.7 | 95.0 |
| EBITDA/revenue*§(%) | 33.5 | 29.3 | 20.6 | 22.9 | 22.4 |
| Capital expense§ | 67.1 | 64.2 | 197.2 | 204.6 | 185.5 |
| Debt | 1,206.3 | 1,205.6 | 1,332.9 | 1,446.3 | 1,575.3 |
| Debt/EBITDA*§(x) | 10.0 | 11.9 | 18.7 | 16.7 | 16.6 |
| Interest expense† | 64.2 | 68.3 | 70.6 | 76.5 | 82.4 |
| EBITDA/interest coverage*§† (x) | 1.9 | 1.5 | 1.0 | 1.1 | 1.2 |
| Cash and liquid assets | 78.9 | 95.8 | 80.3 | 83.0 | 63.8 |

*Adjusted for grant amortization. §Adjusted for capitalized repairs. †Including capitalized interest. a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. e--Estimate. N.A.--Not available.

## Ratings Score Snapshot

Table 2

### The Guinness Partnership 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 |
| Financial policies | 3 |

Table 2

### The Guinness Partnership Ratings Score Snapshot (cont.)

| | |
|---|---|
| Financial profile | 4 |

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: 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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- United Kingdom Outlook Revised To Stable; 'AA/A-1+' Ratings Affirmed, Dec. 17, 2019
- 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

| | | |
|---|---|---|
| **Downgraded; Outlook Action** | | |
| **Guinness Partnership (The)** | | |
| **Issuer Credit Rating** | A-/Stable/-- | A/Negative/-- |
| Senior Secured | A- | A |
| **Ratings Affirmed** | | |
| **Guinness Partnership (The)** | | |
| Senior Secured | AA | AA |

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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.