Research Update:

U.K.-Based Housing Association Peabody Trust 'A-' Rating Affirmed; Outlook Negative

July 7, 2023

Overview

- We project that mitigating actions taken by Peabody Trust's management will ease the pressure on the group's credit metrics through to fiscal year ending March 31, 2026 (fiscal 2026).
- However, we consider that high inflation and rising interest rates could prolong Peabody Trust's recovery longer than we assume in our base case.
- We therefore affirmed our 'A-' long-term issuer credit rating on Peabody Trust. The outlook remains negative.

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Rating Action

On July 7, 2023, S&P Global Ratings affirmed our 'A-' long-term issuer credit rating on U.K.-based housing association Peabody Trust. The outlook is negative.

We also affirmed our 'A-' long-term issuer credit ratings on Town & Country Housing Group, because we consider it to be a core subsidiary of Peabody.

At the same time, we affirmed the 'A-' issue ratings on the senior secured debt issued by TCHG Capital PLC and Peabody Capital No 2 PLC. We consider these two finance vehicles to be core subsidiaries of Peabody.

Outlook

The negative outlook reflects our view that elevated investment in existing homes and rising interest rates, amid inflationary pressure, could further weaken Peabody's financial metrics, despite the management's mitigating actions.

Downside scenario

We could consider lowering the ratings on Peabody over the next 24 months if management fails to mitigate inflationary cost pressures or if investments in existing homes exceed our base-case expectations. Pressure on the debt metrics could also stem from higher-than-anticipated debt-funding of new homes development or rising interest costs.

Upside scenario

We could revise the outlook to stable if we notice a gradual strengthening of Peabody's debt metrics in line with our base case. Specifically, we would consider a stable outlook if management succeeded in reining in costs, resulting in sustained improvement of non-sales adjusted EBITDA. Under this scenario, we would expect the group's non-sales S&P Global Ratings-adjusted EBITDA interest coverage to improve toward 1x.

Rationale

The affirmation reflects our view that Peabody's management actions may gradually yield stronger credit metrics through fiscal 2026, from the weak levels anticipated in fiscals 2023 and 2024 due to gradually rising rent revenue. Peabody benefits from the regulatory regime for English social housing providers with regular rent increases, which we expect will adequately compensate for potential cost inflation following the government cap on rents in fiscal 2024. Peabody has indicated that it will significantly scale back on the development of new homes while continuing to dispose of non-core assets, and we believe both initiatives will help contain the group's buildup of debt. However, we expect inflationary pressure on the cost base and the need to invest in existing homes to result in lower adjusted EBITDA than previously assumed. Meanwhile, although around 80% of Peabody's debt is fixed rate, we nonetheless project that rising interest rates will impact the group's interest costs and that the recovery of non-sales adjusted EBITDA interest cover will be slower than our previous assumptions. Furthermore, we see a risk that the improvement could be further delayed. Under our base case we project an improvement of the coverage ratio to 0.9x by the end of fiscal 2026.

Enterprise profile: Peabody's strong market position and focus on traditional social housing activities underpins its credit quality.

Peabody benefits from generating most of its earnings in the predictable and countercyclical social-housing sector. The company has a strong market position in its main areas of operations in London and the Southeast of England, supported by an average general needs rent at a low level of about 50% of the prevailing market rent. The strong demand for its properties is also evident in the group's vacancy rate--it has averaged 1.5% over the past three years, which we consider to be on par with the sector in England. As a large provider of social housing in the sector, with more than 105,000 units in its portfolio, Peabody is capable of absorbing external shocks, which we regard as a favorable trait.

In our view, Peabody will remain focused on the social and affordable rental sector. We expect the group to lower its exposure to market sales alongside the execution of its plan to reduce new homes development from our last forecasts. We anticipate that Peabody will contain its exposure to sales income, including that generated by joint ventures, at about 18% of the group's total revenue on average in the coming two to three years.

We think the management's efforts to mitigate the headwinds implies that the group is mindful of the sector's challenges and applies a proactive approach to protect its financial metrics. We think the group's plan to reduce new development, alongside the continued disposal of non-core assets, is unlikely to upset the long-term sustainability of operations. Still, we think that the recovery of the group's currently weak credit metrics will be gradual. Moreover, considering the U.K.'s elevated inflation, rising interest rates globally, and that Peabody faces substantial investments in existing stock, we think that executing the strategy as planned could become challenging.

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

Financial profile: Peabody's debt metrics will remain weak despite the management's mitigating actions

We expect the group's financial performance will remain subdued due to the rising cost base amid inflation and the sizable investments in its existing stock. That said, we assume that the group will recover some of its spending, including via the Building Safety Fund and the Social Housing Decarbonisation Fund, partly offsetting the related costs. S&P Global Ratings-adjusted EBITDA and EBITDA margins should improve steadily between now and fiscal 2026. They eroded in fiscal 2023 when inflation exceeded rent increases, and the government's 7% cap on rent increases this fiscal year will stall improvements. We expect that, from fiscal 2025 on, the group will have rent increases that can compensate for inflation. That said, the financial performance could feel additional strain if high inflation persists and the management's plan on cost efficiencies does not fully materialize.

We anticipate that Peabody will accumulate debt at a slower pace because of reduced development compared to our last forecasts. We also think that Peabody can dispose some high-value, non-core assets, which would partly fund development. We therefore forecast that debt buildup will be slower than what we previously assumed. Nevertheless, the cost of debt rose significantly in fiscal 2023 due to the interest expense from the portion of the debts at a variable rate. Consequently, we project a muted recovery of Peabody's debt metrics, with adjusted non-sales EBITDA interest coverage gradually strengthening from the weak level of roughly 0.6x in fiscal 2023 to 0.9x by fiscal 2026.

We view Peabody's liquidity as very strong but see a risk that part of the improvement in liquidity comes from sales of non-core assets that might take time to complete. The group's liquidity sources cover uses by approximately 2.4x in the next 12 months. This is based on our forecast of liquidity sources of about £2.0 billion--comprising cash, undrawn and available revolving credit facilities, asset sales, grant receipts, and cash from operations (adding back the noncash cost of sales)--that will cover liquidity uses of about £855 million (mainly capital expenditure and debt service payments). At the same time, we believe Peabody retains strong access to external liquidity when needed.

Government-related entity analysis

We believe there is a moderately high likelihood that Peabody would receive timely extraordinary support from the U.K. government in the case of financial distress. This provides two notches of uplift from the stand-alone credit profile. 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 instances 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 Peabody.

Table 1

Peabody Trust--Key Statistics

	--Fiscal year ends March 31--				
Mil. £	2022a	2023e	2024bc	2025bc	2026bc
Number of units owned or managed	105,293	106,462	107,036	107,279	108,265
Adjusted operating revenue	942.3	1089.0	1002.5	996.0	1012.3
Adjusted EBITDA	181.9	155.0	153.6	177.2	209.8
Non-sales adjusted EBITDA	154.2	114.0	141.0	165.5	194.4
Capital expense	562.7	523.0	621.9	519.1	557.2
Debt	4435.3	4489.0	4625.0	4773.5	5026.5
Interest expense	151.1	196.0	201.7	208.1	214.3
Adjusted EBITDA/Adjusted operating revenue (%)	19.3	14.2	15.3	17.8	20.7
Debt/Non-sales adjusted EBITDA (x)	28.8	39.4	32.8	28.8	25.9
Non-sales adjusted EBITDA/interest coverage(x)	1.0	0.6	0.7	0.8	0.9

a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Table 2

Peabody Trust--Ratings Score Snapshot

	Assessment
Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	1
Management and Governance	4
Financial risk profile	4
Financial performance	5
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

- United Kingdom Outlook Revised To Stable From Negative On Moderating Fiscal Risks; 'AA/A-1+' Ratings Affirmed, April 21, 2023
- U.K. Social Housing Borrowing 2023: On Pause, March 28, 2023
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings History: March 2023, March 27, 2023
- 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
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 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
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings List

Ratings Affirmed	
Peabody Trust	
Town & Country Housing Group	
Issuer Credit Rating	A-/Negative/--
Peabody Trust	
Senior Secured	A-
Peabody Capital No 2 PLC	
Senior Secured	A-
TCHG Capital PLC	
Senior Secured	A-