S&P Global Ratings

RatingsDirect®

Research Update:

Outlook On U.K.-Based Metropolitan Housing Trust Revised To Negative On Heightened Sales Risk; 'A+' Rating Affirmed

Primary Credit Analyst, Sovereigns And International Public Finance:
Jean-Baptiste Legrand, London (44) 20-7176-3609; jb.legrand@spglobal.com

Secondary Credit Analyst, Sovereigns And International Public Finance:
Ratul Sood, CFA, London +44 (0) 20 7176 6536; ratul.sood@spglobal.com

Research Contributor, Sovereigns And International Public Finance:
Nathalie Poignant, London +44 20 7176 8626; nathalie.poignant@spglobal.com

Table Of Contents

Outlook On U.K.-Based Metropolitan Housing Trust Revised To Negative On Heightened Sales Risk; 'A+' Rating Affirmed

Overview

- U.K.-based social housing provider Metropolitan Housing Trust (Metropolitan) is engaging in some development-for-sale activities, which we consider riskier than traditional social housing activities, amid Brexit uncertainties.
- We believe that Metropolitan's risk management related to its current development plan has so far been appropriate, and that financial performance is sustainable.
- We are affirming our 'A+' long-term issuer credit rating.
- The negative outlook reflects that risks arising from Metropolitan's exposure to a more volatile sector could prompt us to revise down our assessment of its financial profile and lower the rating by one notch in the next two years.

Rating Action

On Oct. 31, 2016, S&P Global Ratings revised to negative from stable its outlook on U.K-based Metropolitan Housing Trust (Metropolitan). At the same time, we affirmed the 'A+' long-term issuer credit rating.

We also affirmed our 'A+' long-term issue rating on Metropolitan Funding PLC's £250 million senior secured bond. Metropolitan Funding was set up for the sole purpose of issuing bonds and lending the proceeds to Metropolitan, and we view it as a core subsidiary of the Metropolitan group.

Rationale

The outlook revision reflects our view of Metropolitan's exposure to a more volatile sector in that it is expanding its involvement in development-for-sale activities. This could pose risks for its financial profile, amid Brexit uncertainties.

The rating affirmation reflects our belief that Metropolitan's financial profile remains strong; its exposure to market sales is slightly less important than for peers; there are appropriate risk mitigation plans in place, including the monitoring of interest coverage from the social housing business; and the business has inherent strengths.

We also understand that Metropolitan has the flexibility to switch tenures while completing one of its key targets, which is to generate annual adjusted EBITDA margins above 30% in the near term. Further, we note that development plans could be amended in the event of a significant downturn in the market.

Metropolitan’s charitable status also affords it some cost advantages compared to purely commercial homebuilders. The increased risks from the exposure to market sales are also mitigated by the fact that Metropolitan would be positioned in the less risky segments of the homebuilding sector, namely low- to medium-value residential buildings (as opposed to high-end commercial construction).

Metropolitan's focus on market sales activities is coming notably from private sales from the Clapham Park estate. We view this as a way to mitigate recent regulatory changes that are putting pressure on its traditional revenue stream, such as cuts to social rents and lower grant levels.

We consider market sales to be riskier than traditional social housing activities because of the higher volatility in demand and price levels inherent in the open market, especially amid Brexit uncertainties. As Metropolitan is planning to generate about 30%-40% of its revenues from development-for-sale activities in the medium term, we may see more pressure on its financial profile.

That said, we forecast a resilient financial performance under our base case (with adjusted EBITDA margins at about 32% on average in 2017-2019) and relatively low debt ratios compared to peers for the next two years (with debt to adjusted EBITDA at about 10x), taking into account the current development program.

The 'A+' rating on Metropolitan is based on its stand-alone credit profile (SACP), which we continue to assess at 'a+', underpinned by our view of Metropolitan’s very strong enterprise profile and still strong financial profile. Our assessment of Metropolitan benefiting from a moderately high likelihood of extraordinary support from the U.K. government (AA/Negative/A-1+), working through the Homes and Communities Agency, in the event of financial distress, has a neutral impact on the rating.

In accordance with our criteria for government-related entities, our view of a moderately high likelihood of extraordinary government support is based on our assessment of Metropolitan’s important role for the U.K. government and its public policy mandate; and its strong link with the U.K. government, demonstrated by the government's track record of providing strong credit support in certain circumstances.

Liquidity

We assess Metropolitan’s liquidity position as strong, reflecting our view that sources are likely to cover uses by about 1.8x over the next 12 months. We also factor in our view of Metropolitan’s satisfactory access to external liquidity.

Sources of liquidity include:

- About £90 million of cash from operations;
- About £35 million of available cash balances;
- £160 million confidently predictable proceeds from asset sales; and

- About £330 million of undrawn committed facilities that expire after 12 months, including £100 million from a retained tranche of bond issuance.

Uses of liquidity include:

- About £240 million of capital expenditure (including capitalized repairs); and
- £95 million of grant and debt service.

Outlook

The negative outlook reflects our view that we could lower the ratings by one notch over the next two years if Metropolitan's plan to increase its exposure to market sales results in increased volatility and pressure on margins.

We could lower the rating if we saw evidence that the increased exposure to market sales had weakened the financial profile more than we currently forecast, for example if higher-than-expected market volatility pushed adjusted EBITDA margins to the 20%-30% range. We would also lower the rating if the liquidity position significantly deteriorated to below 1.75x. In that case, we would also consider revising down our assessment of the group's management.

We could revise the outlook to stable over the next two years if we believed that Metropolitan's strategy, and the risks stemming from exposure to market tenures, was not going to have a material impact on its credit ratios, and if we saw evidence of a strong flexibility to adjust to market changes.

Related Criteria And Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Criteria - Governments - General: Methodology For Rating Public And Nonprofit Social Housing Providers - December 17, 2014
- General Criteria: Group Rating Methodology - November 19, 2013
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- U.K.-Based Metropolitan Housing Trust 'A+' Long-Term Rating Affirmed; Outlook Stable, July 22, 2016
- Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative On Brexit Uncertainties, October 28, 2016

Ratings List

	Rating	
	To	From
Metropolitan Housing Trust Ltd.		

Ratings List Continued...

Issuer Credit Rating		
Foreign and Local Currency	A+/Negative/--	A+/Stable/--
Senior Secured		
Local Currency	A+	A+
Metropolitan Funding PLC		
Senior Secured		
Local Currency	A+	A+

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.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site 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.