FitchRatings

RATING ACTION COMMENTARY

# Fitch Revises A2Dominion Housing's Outlook to Negative; Affirms at 'A'

Fri 18 Oct, 2024 - 5:50 AM ET

Fitch Ratings - London - 18 Oct 2024: Fitch Ratings has revised the Outlooks on A2Dominion Housing Group Limited's (A2D) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) to Negative from Stable and affirmed the IDRs at 'A' and Short-Term IDR at 'F1+'.

The revision of the Outlook reflects the risk that A2D's credit profile will weaken over the five-year forecast period to a level no longer commensurate with the current rating, given the limited headroom.

Fitch views A2D as a government-related entity (GRE) of the United Kingdom (AA-/Stable). We have 'Strong expectations' that the state would provide support to A2D. This leads to a one-notch uplift from its Standalone Credit Profile (SCP), which we assess at 'a-', three notches below the sovereign. Continuing high demand for social and affordable housing and ongoing cash flow from rented properties support A2D's credit profile, despite the challenging economic environment.

## KEY RATING DRIVERS

### Support Score Assessment 'Strong expectations'

We have 'Strong expectations' of extraordinary support from the United Kingdom for A2D in case of need, reflecting a support score of 20 (out of a maximum 60) under Fitch's GRE criteria. This reflects a combination of responsibility to support and incentive to support factors assessment as below.

### Responsibility to Support

#### Decision Making and Oversight 'Strong'

As a private, not-for-profit social housing registered provider (RP) in the UK, A2D is not owned by the UK government due to its structure and status. In strict terms there is no legal owner, with all surpluses reinvested to provide social housing. We consider the regulatory framework for English social housing as having a robust legal basis, and the Regulator of Social Housing as maintaining sound control and tight monitoring of RPs. The regulator's history of oversight and (non-financial) intervention in (rare) cases of distress is a key factor behind the sector's solidity.

#### Precedents of Support 'Strong'

A2D receives ongoing financial support through grants from Homes England and the Greater London Authority for social, affordable and shared ownership development. This is to support additional subsidised housing, not to finance debt or prevent default. Fitch takes into account the support mechanisms the issuer can benefit from, or has benefited from, via the sponsor, the UK. Policy influence is supportive of the financial stability of RPs. Regulatory restrictions on government support are unlikely to prevent timely intervention in exceptional circumstances.

### Incentives to Support

#### Preservation of Government Policy Role 'Strong'

Social housing is a key public service. There would be no immediate impact on the service in case of default, but there would be a medium-term impact on the provision of service as RPs rely on external financing to finance maintenance capex and new investments. In the unlikely event of financial default, other RPs could act as substitutes, with only temporary disruption to the service offered by the RP and diminished medium-term service provision due to reduced financial resilience and access to finance.

#### Contagion Risk 'N/A'

Default would have a minimal impact on the availability or cost of domestic financing for the UK. Fitch considers that if a default occurred, it would be treated as an isolated case of mismanagement or viability concerns Consequently, this should not affect the sector as a whole.

**Standalone Credit Profile**

A2D's 'a-' SCP reflects the combination of a 'Stronger' risk profile and a financial profile assessed at the lower-end of the 'bbb' category, with forecast leverage expected to return to below 12x by FY29 (FY24:18.2x)

**Risk Profile: 'Stronger'**

Fitch assesses A2Dominion's risk profile at 'Stronger'', reflecting the combination of assessments:

**Revenue Risk: 'Stronger'**

We assess demand as 'Strong', reflecting that demand for social housing remains strong in London and the south east, the main areas in which A2D operates. Any change in the rents charged by A2D is unlikely to materially affect demand.

Pricing is assessed as 'Stronger' despite a lack of flexibility in setting social and affordable rents. The UK government sets the threshold for annual social rent increases, but A2D has flexibility over pricing from its non-social housing lettings activity, which it uses to cross-subsidise the core business. Fitch expects rent increases to return to CPI+1% from FY24, following the 7% cap that was applied in April 2023 for one year.

**Expenditure Risk: 'Stronger'**

A2D has well-identified cost drivers and low potential volatility in major items. Staff costs are the most rigid cost item and account for more than 20% of cash outflow, in line with some of the strongest peers in the sector. A2D has no material supply constraints on labour or resources.

In the financial year ending March 2024 (FY24), A2D invested GBP97 million in its existing stock, which includes planned maintenance, major works, building safety, and repairs. Currently, 99.9% of the total stock is compliant with the Decent Homes Standard. The portfolio is fairly new as 45% of the stock was built post-2002, leading to relatively lower average repairs and maintenance costs. 80% of stock meets Energy Performance Certificate (EPC) rating of 'C', and A2D has allocatedGBP7.8 million in its business plan to attain 100% compliance by 2030.

A2D completed 668 homes during FY24, including 329 social, affordable, and shared ownership homes. A2D plans to deliver 570 new homes (17% affordable rent, 63% private development and 20% shared ownership) in FY25. In general, A2D has the flexibility to slow down committed schemes or defer uncommitted schemes, and to switch tenure from sale to market rent or affordable rent, supported by grant funding.

**Liabilities and Liquidity Risk: 'Stronger'**

The group has broad access to finance across the banking sector and debt capital markets. A2D's debt is similar to sector peers, spread across bonds, a revolving credit facility, and term loans, with several lenders. At 31 March 2024, drawn debt totalled GBP1.5 billion, of a total GBP1.9 billion, and 42% of this was bank loans, with margins ranging from 0.325% (plus SONIA + CAS) to 5.97% (fixed). The weighted average cost of funds on group debt was 4.7%. The majority of borrowing (about 86%) is fixed-rate. Debt maturity is well within the expected economic life. The weighted average life of outstanding borrowing is about eight years.

At FYE20, A2D had GBP45.5 million in cash and liquid investments. A2D generally aims to minimise the liquid cash that it holds, seeking to maximise its return through investment, but ensures sufficient loan facilities are in place to fund future liquidity requirements. It had a GBP500 million revolving credit facility (GBP351.1 million secured undrawn) at 31 March 2024.

**Financial Profile 'bbb'**

Fitch assesses A2D's financial profile at 'bbb'. Performance has deteriorated due to sector challenges like building safety spend and energy efficiency reinvestment, but A2D aims to recover financial resilience by limiting future development, disposing off non-core assets, and re-investing efficiencies. We expect leverage to improve as these costs diminish. Net adjusted debt/EBITDA peaked at 18.2x in FY24 but we expect it to average around 10x in the final two years of our rating case and 11.5x over the five years to FY29.

Fitch stresses management's expectations to achieve its rating-case scenario. In our rating-case scenario, A2D's operating revenue will average GBP358 million in FY25-FY29, with EBITDA averaging GBP110 million annually. We expect net adjusted debt/EBITDA to structurally lower to 11x due to higher capital receipts from asset disposals and a reduced capex plan, but this would be partly offset by the need for reinvestment in existing stock.

In FY24, A2D's operating revenue was GBP384 million (FY23: GBP377 million), with EBITDA of GBP84 million (FY23: GBP78 million). Net debt at FYE24 was GBP1,497 million.

### Additional Risk Factors Considerations

Asymmetric risk attributes are all assessed as 'Neutral' due to a strong regulatory framework, transparent reporting of information and a risk averse debt structure. The debt is mostly fixed rate and vanilla in nature (sterling bonds and bank debt). Governance and management are assessed by the regulator. They operate under English law, which is considered strong, and their Country Ceiling is 'AAA' (United Kingdom). Information quality is strong, with external publications internally and externally audited.

### Derivation Summary

A2D's rating is driven by its 'a-' SCP. This is driven by a 'Stronger' risk profile and 'bbb' financial profile, and comparison with peers in the sector. We view A2D as a GRE in the UK, with a support score of 20 points. This results in a bottom-up approach, with a one-notch uplift from the SCP to the 'A' Long-Term IDR.

### Short-Term Ratings

A2D's Short-Term 'F1+' IDR is the higher of two options mapping to a 'A' Long-Term IDR, reflecting the combination of 'Stronger' revenue defensibility and strong liquidity cushion and coverage ratios.

### Issuer Profile

A2D is one of the largest registered providers of social housing in the south of England, with about 38,000 units (excluding garages and community centres). It is a member of the G15 group of London's largest housing associations.

## KEY ASSUMPTIONS

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on FY20-FY24 historical figures and FY25-FY29 scenario assumptions.

## RATING SENSITIVITIES

### Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A multi-notch downgrade of the UK sovereign, a sustained deterioration of net debt/EBITDA above 12x on a sustained basis, or an adverse change to our assessment of key rating factors. Fitch will monitor the progress of A2D's asset disposal programme and its impact on the financial profile and key leverage metrics.

### Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

We could revise the Outlook to Stable if there is a continued improvement in net debt/EBITDA below 12x in the medium term.

### ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

### References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | | PRIOR |
|---|---|---|---|---|
| A2Dominion Housing Group Limited | LT IDR | A Rating Outlook Negative | Affirmed | A Rating Outlook Stable |
| | ST IDR | F1+ | Affirmed | F1+ |
| | LC LT IDR | A Rating Outlook Negative | Affirmed | A Rating Outlook Stable |
| | LC ST IDR | F1+ | Affirmed | F1+ |
| senior unsecured | LT | A | Affirmed | A |
| A2D Funding II plc | | | | |
| senior unsecured | LT | A | Affirmed | A |

VIEW ADDITIONAL RATING DETAILS

## FITCH RATINGS ANALYSTS

**Aditi Bhandari**
Associate Director
Primary Rating Analyst
+44 20 3530 2647
aditi.bhandari@fitchratings.com
Fitch Ratings Ltd
30 North Colonnade, Canary Wharf London E14 5GN

**Ines Callahan**
Director
Secondary Rating Analyst
+34 93 467 8745
ines.callahan@fitchratings.com

**Samuel Kwok, CFA, CAIA**
Regional Head of APAC IPF, Senior Direct
Committee Chairperson
+852 2263 9961
samuel.kwok@fitchratings.com

## MEDIA CONTACTS

**Athos Larkou**
London
+44 20 3530 1549
athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com

## PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

## APPLICABLE CRITERIA

Public Policy Revenue-Supported Entities Rating Criteria (pub. 12 Jan 2024) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub. 09 Jul 2024)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| A2D Funding II plc | UK Issued, EU Endorsed |
| A2Dominion Housing Group Limited | UK Issued, EU Endorsed |

## DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.



READ LESS

## SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

## ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.