S&P Global
Ratings

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Research Update:

U.K.-Based Accent Group Ltd. Outlook Revised To Negative From Stable; 'A+' Rating Affirmed

July 21, 2020

Overview

- Higher investments in existing stock than we had previously forecast will continue to strain Accent Group Ltd.'s profitability over the two-year outlook horizon.
- We expect the group will suffer delays in delivering its planned development, because COVID-19 will bring capacity constraints.
- Accent's focus on traditional housing activities and its very strong liquidity continue to support the rating.
- We are therefore revising our outlook to negative from stable and affirming our 'A+' our long-term issuer credit rating on the group.
- The negative outlook reflects our view that Accent's financial profile is under pressure, at a time of heightened risk from economic uncertainty.

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Rating Action

On July 21, 2020, S&P Global Ratings revised its outlook on U.K.-based social housing provider Accent Group Ltd. to negative from stable. At the same time, S&P Global Ratings affirmed it 'A+' long-term issuer credit rating on Accent.

We also affirmed our 'A+' issuer credit rating on Accent Capital PLC and our 'A+' issue rating on the £350 million bond Accent Capital issued in July 2019, of which £125 million was retained. The company was set up to issue bonds and lend proceeds to Accent Housing Ltd., and we view it as a core subsidiary of the group.

Rationale

The outlook revision reflects our view that Accent's increasing investments in its existing stock are straining profitability more than we had forecast. We expect that performance will remain subdued over the forecast period, because we expect high levels of planned maintenance and capitalized repairs that the entity has undertaken over the past year will continue over the forecast period. We believe COVID-19 will also bring capacity constraints in delivering the group's planned development, and the group will suffer delays compared with its target of delivering 400-500 units per year over the forecast period.

As with other English housing associations, we believe there is a moderately high likelihood that Accent would receive extraordinary support in case of financial distress. This provides a one-notch uplift from the 'a' stand-alone credit profile. Accent's primary purpose is to provide affordable homes, supporting important policy objectives of the U.K. government. We believe the Regulator of Social Housing (RSH), a government agency, regulates Accent to promote a viable, efficient, and well-governed social housing sector, and maintain lender confidence and low funding costs across the sector. Therefore, in our view, the RSH would step in to prevent a default in the sector, based on its record of being willing and able to provide extraordinary support on a timely basis.

The economic fundamentals of Accent's main areas of operation are not very dynamic, with 10-year annual population growth averaging about 0.4% and social rents representing 59% of market rents. Accent owns and manages about 20,700 homes, which are concentrated across North, East, and South England, with key locations including Bradford, Peterborough, and Surrey Heath. The group maintains strong operational performance, with vacancies below 1% of rent and service charges on average over the past three years, and low arrears compared with those of peers.

We expect Accent's core business will remain one of low-income social housing activities, which supports our view of predictable revenue streams and low industry risk. The housing portfolio mainly includes general needs housing, which accounted for about 72% of total turnover in fiscal year (FY) 2020. We expect that the group will continue to develop units for sale over the forecast period, but that exposure to these activities will be limited. We forecast that, on average, only 7.3% of turnover will come from shared ownership and outright sale receipts over the forecast period, reflecting management's aim to focus on traditional affordable rental tenures.

Over the past two years, the group has taken a proactive approach to asset management, reviewing replacement component lifecycles, carrying out stock condition surveys and introducing a new repair and maintenance strategy. This strategy has resulted in higher investment in its existing stock, stressing margins. However, despite this proactive approach, the group is still not fully compliant with Decent Homes Standards. We positively view that management is aiming to increase the quality of existing homes, because this will attract higher demand and support strong operational performance.

We expect Accent will suffer delays in regard to the delivery of its planned development, because COVID-19 will bring constraints in terms of contractor capacity and some development sites were closed for several months. Before the pandemic, management was targeting increasing the size of its development to deliver 400-500 homes per year during FY2022-FY2023. The group has slightly updated the development plan to reflect reduced units per year but with a longer overall duration. Management has also lowered the group's exposure to outright sales activities, because its plan last year included 210 units developed for private sale but the current version only includes 15 units.

Our base-case scenario forecasts a deterioration in Accent's S&P Global Ratings-adjusted EBITDA margins to average 23% over the next three years. Increased planned maintenance and capitalized repairs for existing units will continue to pressure profitability. These higher costs relate to additional investment in respect of component replacement lifecycles, Decent Homes Standards compliance, and fire safety expenditure. Capitalized repairs have more than doubled to £13.4 million in FY2020 from £5.3 million in FY2018, and we expect they will remain elevated over the forecast period, averaging £12.5 million. We expect that in FY2023, toward the end of the forecast period, margins will recover slightly as the ramp-up in development combined with the

CPI plus 1% rent regime will counterbalance increased costs.

Over the next three years, and in line with our expectation that the group will suffer delays in development, we expect Accent will only increase its debt position by about £40 million, to stand at £438 million in FY2023. We expect the adjusted debt-to-EBITDA ratio to deteriorate in 2020, linked to our expectation of weaker profitability, but that this ratio will recover toward the last two years of the outlook horizon. We forecast that Accent's debt to adjusted EBITDA will average 17.4x over FY2021-FY2023, and improve toward 16x in FY2023. We anticipate the group's interest coverage will remain adequate, averaging 1.6x in FY2021-FY2023. Last year's bond issuance enabled Accent to secure new debt at an attractive coupon while using proceeds to repay legacy debt with high average interest rate, supporting this ratio.

Liquidity

We assess the group's liquidity position as very strong and one of the rating's key strengths. Over the next 12 months, we expect sources of liquidity to exceed planned uses by about 2.4x. With several committed facilities with a variety of lenders and its benchmark £350 million bond issuance--of which £125 million was retained--we view Accent's access to external liquidity as satisfactory.

We forecast that liquidity sources will include:

- Our forecast of cash from continuing operations of £22 million
- Cash and liquid investments of £128 million
- The undrawn, available portion of committed bank facilities or bank lines maturing beyond the next 12 months of £30 million
- Other receipts constituting £11 million of grant receipts

We forecast that uses of liquidity will include:

- Our expectation of capital expenditure of £62 million
- Interest and principal payments on debt of £18 million

Outlook

The negative outlook reflects our view that Accent's financial profile is under pressure, at a time of heightened risk because of economic uncertainty related to COVID-19. Should the group continue to ramp up development over this period, the debt burden might be materially higher than we envisage.

We could lower the rating on Accent if management targeted a ramp-up in development efforts, which would strain funding needs more than we expect. We could also lower the rating if management deviated from its strategy and relied heavily on sales activities, which would increase the volatility in the group's surplus. We could also lower the rating on Accent if we estimated that there was a lower likelihood of the group receiving timely and sufficient extraordinary support from the U.K. government, through the RSH, in the event of financial distress.

An upgrade would depend on the group's profitability performing better than our base-case, with debt remaining moderate below 15x adjusted EBITDA. Under this scenario, we would expect the group's asset quality to improve and fully comply with Decent Homes Standards.

Key Statistics

Table 1

Accent Group Ltd.--Key Statistics

	--Year ended March 31--				
(Mil. £)	2019a	2020a	2021bc	2022bc	2023bc
Number of units owned or managed	20,623	20,721	20,834	21,252	21,658
Revenue§	93.0	95.7	94.4	110.7	108.6
Share of revenue from sales activities (%)	1.0	3.0	3.9	11.9	6.2
EBITDA§†	21.6	20.8	20.9	24.8	27.4
EBITDA/revenue §†(%)	23.2	21.7	22.2	22.4	25.2
Capital expense†	14.7	31.8	52.8	75.8	55.0
Debt	315.6	411.4	408.5	413.7	438.0
Debt/EBITDA §†(x)	14.6	19.8	19.5	16.7	16.0
Interest expense*	14.3	14.1	14.7	14.7	15.1
EBITDA/interest coverage§†* (x)	1.5	1.5	1.4	1.7	1.8
Cash and liquid assets	46.4	108.8	74.2	35.1	41.9

*Including capitalized interest. §Adjusted for grant amortization. †Adjusted for capitalized repairs. 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

Accent Group Ltd.--Ratings Score Snapshot

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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: Group Rating Methodology, July 1, 2019
- 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 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 24, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020
- U.K. Social Housing Ratings History: February 2020, March 3, 2020
- Why Most Rated U.K. Social Housing Providers Are At Home In The 'A' Category, Dec. 3, 2019

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Accent Group Ltd.		
Issuer Credit Rating	A+/Negative/--	A+/Stable/--
Accent Capital PLC		
Issuer Credit Rating	A+/Negative/--	A+/Stable/--
Senior Secured	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. 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.