Research Update:

U.K.-Based Futures Housing Group 'A+' Rating Affirmed; Outlook Stable

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Overview

- Futures Housing Group (FHG) has a highly predictable revenue stream from rental activities and we view management practices as conservative.
- Although we expect inflationary pressures on its cost base to weigh on the group's performance, we estimate that nonsales interest cover will remain robust and that the group's strategy will lead to a substantial reduction of its debt by the fiscal year ending March 31, 2025 (fiscal 2025).
- We affirmed our 'A+' long-term issuer credit rating on FHG.
- The outlook is stable.

Rating Action

On Oct. 19, 2022, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on FHG. The outlook is stable.

At the same time, we affirmed our 'A+' issue rating on the £270 million bond issued in February 2019 by Futures Treasury PLC, the group's funding vehicle set up for the sole purpose of issuing bonds and lending the proceeds to FHG.

Outlook

The stable outlook reflects our expectation that the group's strategy will result in a strengthening of its debt metrics and sustained very strong liquidity.

Downside scenario

We could lower the rating if the group's strategy became more aggressive, such that its exposure to sales risk increased meaningfully. The rating could also come under pressure if FHG were to significantly ramp up its investments in new and existing homes, which in our view would likely require debt funding. This would likely result in weaker financial metrics and a materially weaker liquidity position, and could hamper our view of FHG's management.

Upside scenario

An upgrade would depend on a consistent strengthening of FHG's S&P Global Ratings-adjusted EBITDA, resulting in stronger adjusted EBITDA margins over 40%, with a sustained adjusted debt to nonsales EBITDA ratio below 10x and adjusted nonsales EBITDA interest coverage over 2.5x.

Rationale

The rating reflects our expectation that FHG's strategy will lead to a strengthening of the group's debt metrics and sustained very strong liquidity position, since we expect the group to primarily fund the development of new homes with its existing cash reserves. This is despite our expectation of lower EBITDA margins, since the group faces inflationary cost pressures that rent increases will not fully offset. This, combined with planned investments on existing stock, results in adjusted EBITDA margins reducing to below 30% through our forecast.

FHG has kept a conservative approach toward market activities. Through our forecast, we expect sales exposure to be contained below 15% of total revenue and to relate only to first-tranche sales of shared ownership units. This supports our expectation of a highly predictable revenue stream from core, traditional activities.

FHG operates throughout the East Midlands, owning and managing more than 10,000 units. Although we estimate that the gap between average social housing rent to market rent in this area of operations is relatively high, at about 70%, we think demand for social housing remains steady. Vacancy rates have averaged about 1.3% over the past three years. These halved to 0.9% over fiscal 2022 after peaking during the previous two years to about 1.7% due to higher relet times during pandemic-related lockdowns.

In our view, management is experienced and stable with strong expertise to deliver on a strategy that should result in a strengthening of its debt metrics. For example, the group has prolonged the development plan to accommodate the rising inflationary pressures. We view governance and risk management standards as prudent and suitable for the organization and its operating environment. We also note that the group follows robust financial policies, such as prefunding its development, which have resulted in robust cash reserves and solid interest cover.

We expect FHG's debt to nonsales EBITDA ratio to improve through fiscal 2025, with nonsales interest cover remaining stable and robust. Following the group's strategy to prefund the development of new homes by tapping the market over the past two fiscal years, we expect the accumulated large cash reserves to be sizable enough to fund development through fiscal 2025, as well as upcoming maturities. Furthermore, FHG has decided to extend its development strategy to build 1,200 units by one year, which results in a scaling down to 250 units per year from 300 previously.

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," published June 8, 2021).

We think there is a moderately high likelihood that FHG would receive extraordinary support from the government via the RSH in case of financial distress. However, the final rating does not incorporate any uplift from the stand-alone credit profile (SACP), which we assess at 'a+'. Since one of the key goals of the RSH is to maintain lender confidence and low funding costs across the sector, we think the RSH is likely to step in to try to prevent a default in the sector. The RSH has a record of mediating mergers or arranging liquidity support from other registered providers in cases of financial distress, and we think this would apply to FHG.

Liquidity

Our assessment of FHG's very strong liquidity position is based on its very high cash levels, substantial amount of undrawn bank lines, and satisfactory access to capital markets.

In our base case over the next 12 months, we estimate sources of about £200 million will cover uses by 4.3x. However, we expect the liquidity ratio to trend down in the following years because we expect the group to utilize its large cash reserves to fund capital expenditure (capex).

Sources of liquidity include:

- Cash and liquidity investments of about £135 million;
- Cash flow from operations adding back the noncash cost of sales about: £22 million;
- Proceeds from asset sales of about £1 million;
- Undrawn committed facilities of about £39 million; and
- Expected ongoing cash injections from the government of about £3 million.

Uses of liquidity include:

- Expected capex just below £30 million; and
- Interest and principal repayment of about £17 million.

Key Statistics

Table 1

Futures Housing Group--Key Statistics

	--Year ended March 31--				
Mil. £	**2021a**	**2022a**	**2023e**	**2024bc**	**2025bc**
Number of units owned or managed	10,315	10,398	10,592	10,805	11,017
Adjusted operating revenue	61.3	58.8	61.3	61.0	70.3
Adjusted EBITDA	18.6	15.9	17.3	18.0	17.4
Non-sales adjusted EBITDA	17.4	15.4	17.2	18.0	17.3
Capital expense	23.5	27.8	28.7	30.1	32.9
Debt	267.7	336.8	330.7	327.7	295.4
Interest expense	10.4	10.2	12.5	12.3	11.3
Adjusted EBITDA/Adjusted operating revenue (%)	30.3	27.0	28.2	29.5	24.8
Debt/Non-sales adjusted EBITDA (x)	15.4	21.9	19.2	18.2	17.1
Non-sales adjusted EBITDA/interest coverage(x)	1.7	1.5	1.4	1.5	1.5

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

Ratings Score Snapshot

Table 2

Futures Housing Group--Ratings Score Snapshot

	Assessment
Enterprise risk profile	2
Industry risk	2
Regulatory framework	3
Market dependencies	3
Management and Governance	2
Financial risk profile	3
Financial performance	4
Debt profile	4
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 Negative On Rising Fiscal Risks; 'AA/A-1+' Ratings Affirmed, Sept. 30, 2022
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 2022
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021

- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Outlook 2021: Strong Liquidity Should Help Social Housing Providers Remain Resilient, Dec. 8, 2020
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020

Ratings List

Ratings Affirmed	
Futures Housing Group	
Issuer Credit Rating	A+/Stable/--
Futures Treasury PLC	
Senior Secured	A+