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Research Update:

U.K. Social Housing Provider Cross Keys Homes Ltd. 'A+' Rating Affirmed; Outlook Stable

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Overview

- Cross Keys Homes Ltd. (CKH) benefits from high population growth above the national average and high housing demand where it operates.
- Exposure to nontraditional activities is increasing through a growing appetite for shared ownership, but we expect this to remain less than one-third of revenues through 2021.
- We expect that CKH will continue to record strong financial performance with EBITDA margins above 30% and only limited debt increases over the forecast horizon.
- We are therefore affirming our 'A+' long-term rating on CKH.
- The stable outlook reflects our expectation that CKH will maintain strong profitability through 2021, supported by high demand for housing, controlled costs, a new rent regime taking effect in 2021 removing rent cuts, and only a limited increase in debt.

Rating Action

On May 15, 2018, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K. social housing provider Cross Keys Homes Ltd. (CKH). The outlook is stable.

At the same time, we affirmed our 'A+' issue rating on the £150 million bond issued in September 2014 by Cambridgeshire Housing Capital PLC, CKH's funding vehicle. Cambridgeshire Housing Capital PLC was set up for the sole purpose of issuing bonds and lending the proceeds to CKH, and we view it as a core subsidiary of the Cross Keys group.

Rationale

The affirmation is based on our assessment of CKH's stand-alone credit profile (SACP), which we continue to assess at 'a+'. We believe that CKH benefits from high housing demand in its areas of operation, high margins, and its controlled debt.

The rating reflects our view of the low industry risk under which CKH operates and its strong economic fundamentals, notably thanks to its geographic coverage. The company covers the most dynamic areas of the East of England, marked by growth in market rents in recent years. For CKH, this translates into high demand for social housing and very low vacancy rates at about 1% of net rental income over the past three fiscal years.

We also continue to factor into our rating the exposure to nontraditional activities, which we estimate will account for more than 25% of CKH's revenues in our base case for 2019-2021. The higher exposure follows a growing appetite for shared ownership in CKHs' areas of operation. We consider that first-tranche sales associated with shared ownership expose CKH to a riskier and more volatile sector than traditional social housing rental business. This therefore somewhat limits our view of CKH's financial performance. However, we anticipate that this activity will not exceed one-third of CKH's revenues in the next three years.

We believe CKH's management is responding positively to the sector's welfare reforms. As we anticipated in our base case for 2017, despite an expected 1% decrease in social housing revenues through 2020, we expect CKH will tightly control its expenditures and assume that it will be affected only slightly by Universal Credit's stoppage of direct government payments for social housing rents. We expect the new rent policy regime taking effect in 2021 will positively affect CKH, as the rent cuts will disappear, making it possible to increase the rent.

We believe that CKH has a strong financial profile, supported by strong EBITDA margins, which we project will stand at 35% annually on average in our 2019-2021 base case (in line with our former base case), thanks to efficient cost management. This is despite the impact of rent cuts that will continue to weigh on CKH's revenue flows over 2019-2020, although we expect CKH to start increasing the rent from 2021 when the new rent policy regime takes effect.

In our view, CKH has adequate financial policies in place, which support its development program to build about 450 new homes per year, up from 400 anticipated in our former base case. However, we understand that only half of the plan is currently contractually committed, which we think gives CKH some flexibility. We believe that CKH will continue recording higher levels of capital expenditures in 2019 and 2020, funded by operating activities and new £80 million revolving credit facilities (RCF) that is already contracted and secured. We forecast a modest debt increase for CKH, reaching £343 million at fiscal year-end 2021 (March 31), and we expect our adjusted ratio of debt to EBITDA will stand at 11.9x in 2021, compared with 11.5x fiscal year-end 2018.

Thanks to its wide margins, CKH should also continue to post a solid EBITDA interest-coverage ratio of 2x in our forecast period. Based on CKH's latest valuation, we continue to anticipate that the loan-to-value ratio will stand below 70% in our base-case scenario, reflecting the entity's controlled debt.

Our assessment that CKH benefits from a moderately high likelihood of extraordinary support from the U.K. government working through the regulator of social housing, in the event of financial distress, has a neutral impact on the rating.

We regard CKH as a government-related entity. We base our view of a moderately high likelihood of extraordinary government support on our assessments of CKH's important role for the U.K. government through 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 view CKH's overall liquidity position as strong. We consider the company has satisfactory access to external liquidity, illustrated by its £150 million bond issuance in 2014 and its access to a diversified pool of domestic banks. We note a strengthening in the liquidity coverage ratio following new RCF of £80 million, and, as of March 31, 2018, we think sources of liquidity will cover uses by more than 2x over the ensuing 12 months. We believe this strengthening is temporary because we expect CKH to use its facilities as funding, which will decrease the coverage ratio, although it will nevertheless remain strong.

Liquidity sources include about £150 million resulting from availabilities and cash from operations. Liquidity uses include about £65 million comprising expected capital expenditures to support the development program, maturing debt, and interest payments.

Outlook

The stable outlook reflects our expectation that CKH will maintain strong profitability and increase debt only modestly over the next two years, while not exceeding the level of exposure to nontraditional activities we anticipate in our base case.

We could lower our rating if CKH posted a weaker financial performance and failed to contain its development program within the parameters of its current business plan. Such a deviation from the current plan would weaken our adjusted ratio of debt to EBITDA and would suggest both limitations to CKH's strategic planning and a lack of consistency.

We could upgrade CKH by one notch if we saw a substantial improvement in the housing provider's financial profile and if its strategy proved more successful than we currently expect in our base case, such that adjusted EBITDA to revenue stood sustainably well above 40%, and also benefited from further cost reductions. We consider this would also be positive for CKH's liquidity position and its debt profile, because it would significantly improve EBITDA interest coverage.

Both our upside and downside scenarios are unlikely at this stage.

Key Statistics

Table 1

Cross Keys Homes Ltd. Key Statistics

	--Fiscal year ending March 31--				
(000s £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
Number of units	10,840	11,306	11,736	12,223	12,559
Vacancy rates (% of net rental income)	0.54	0.67	N.A.	N.A.	N.A.
Arrears (% of net rental income)*	1.89	2.35	N.A.	N.A.	N.A.
Revenue§	64.75	73.66	72.68	80.68	77.94

Table 1

Cross Keys Homes Ltd. Key Statistics (cont.)

	--Fiscal year ending March 31--				
(000s £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
Share of revenue from non-traditional activities (%)	21.70	28.80	25.70	31.20	25.10
EBITDA†	24.73	25.72	28.46	29.91	28.78
EBITDA/revenue (%)	38.20	34.90	39.20	37.10	36.90
Interest expense	11.55	13.07	13.40	13.98	14.54
Debt/EBITDA (x)	11.8	11.5	10.9	11.0	11.9
EBITDA/interest coverage (x)††	2.1	2.0	2.1	2.1	2.0
Capital expense	37.00	43.91	45.00	40.51	37.92
Debt	291.84	294.88	310.81	327.77	343.19
Housing properties (according to balance sheet valuation)	478.72	512.92	548.20	579.77	608.83
Loan to value of properties (%)	61.0	57.5	56.7	56.5	56.4
Cash and liquid assets	59.53	41.41	34.59	34.02	31.83

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

Cross Keys Homes Ltd. Ratings Score Snapshot

Key rating factors	
Industry risk	2
Economic fundamentals and market dependencies	2
Strategy and management	2
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	4
Debt profile	3
Liquidity	3
Financial policies	2
Financial profile	3

S&P Global Ratings' analysis of social housing providers' creditworthiness rests on our scoring of eight key rating factors: (i) industry risk; (ii) economic fundamentals and market dependencies; (iii) strategy and management; (iv) asset quality; (v) financial performance; (vi) debt profile; (vii) liquidity; and (viii) financial policies. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published Dec. 17, 2014, and "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015, detail how we derive and combine the scores, and then determine each social housing provider's stand-alone credit profile and the issuer credit rating. In accordance with S&P Global Ratings' public and nonprofit social housing providers methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating, the committee can make use of the flexibility afforded by paragraphs 12-17 of "Methodology For Rating Public And Nonprofit Social Housing Providers."

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

- Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative - April 27, 2018

Ratings List

	Rating	
	To	From
Cross Keys Homes Ltd.		
Issuer Credit Rating		
Foreign and Local Currency	A+/Stable/--	A+/Stable/--
Cambridgeshire Housing Capital 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.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.

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