Research Update:

U.K.-Based Social Housing Provider VIVID Housing Ltd. 'A' Rating Affirmed; Outlook Stable

July 20, 2023

Overview

- We project U.K. social housing provider VIVID Housing Ltd.'s (VIVID's) S&P Global Ratings-adjusted EBITDA margins will weaken due to increasing investments in existing homes and cost inflation but remain above a very solid 30% through our forecast period to March 31, 2026 (fiscal year 2026).
- Likewise, we forecast the group's nonsales-adjusted debt metrics will weaken due to higher interest rates, but remain strong compared with many peers and gradually recover through to fiscal 2026.
- We affirmed our 'A' long-term issuer credit rating on VIVID. The outlook is stable.

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Rating Action

On July 20, 2023, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on U.K. social housing provider VIVID. The outlook is stable.

We also affirmed our 'A' issue rating on Peninsular Capital PLC's senior secured and unsecured EMTN program. Peninsular Capital is a special-purpose finance vehicle set up for the sole purpose of issuing bonds and lending the proceeds to VIVID. We view Peninsular Capital as a core subsidiary of VIVID.

Outlook

The stable outlook reflects our view that a steady increase in rental revenue and relatively stable investments in existing homes will mitigate the effect of inflation on the group's financial performance. We also consider that the group's debt metrics will gradually improve from the relatively weak levels in fiscal 2023, thanks to a more contained debt funding need through fiscal 2026.

Downside scenario

We could lower the rating on VIVID if cost inflation or higher than expected investments in existing homes reduce the group's adjusted EBITDA margins. Pressure on the ratings could also follow if management deviates from its strategy, such that new home developments increase significantly above our current expectations, leading to even higher sales exposure or a need to raise more debt. We could downgrade the company if we assess that the likelihood of support from the U.K. government, via the Regulator of Social Housing (RSH), has weakened.

Upside scenario

We could raise the rating on VIDID if we perceive that its exposure to sales risk has reduced. We consider that, in combination with prudent control of operating costs and investments in existing homes, this could result in materially stronger adjusted EBITDA margins. We could also consider raising the ratings if VIVID continues to demonstrate debt metrics strengthening, all else equal.

Rationale

The rating affirmation reflects our view that VIVID's adjusted credit metrics will remain solid through to fiscal 2026. We estimate that the group's credit metrics weakened in fiscal 2023, from very strong levels in prior years. This is owing to cost inflation significantly exceeding rent increases whilst VIVID stepped-up investments in its existing homes. Going forward, we expect rent increases will exceed cost inflation and consider that obtained grants from the Social Housing Decarbonization Fund (SHDF) will mitigate the implications of the group's increasing investments in existing homes.

We further expect VIDID will scale back its new home developments to accommodate for increasing investments in existing homes and higher interest rates, and therefore project a more contained debt buildup than previously. That said, we estimate the group's debt increased by more than we expected in fiscal 2023. Furthermore, VIVID's floating-rate debt will carry higher interest amid the current interest rate environment. We therefore forecast higher than previously forecast interest costs and, as a result, see some pressure on the group's adjusted EBITDA interest coverage from the previously very strong levels.

Enterprise profile: Underpinned by strong management and solid operational metrics, mitigating the group's relatively high exposure to sales risk

VIVID benefits from generating most of its earnings in the predictable and countercyclical social-housing sector. The group owns and manages around 35,000 homes in the southeast of England, which remains relatively affluent compared with the rest of the country. The group continues to see strong demand for its properties, evidenced by solid operational metrics. Its average social and affordable rents are relatively low at just below 60% of the average market rent in the region. VIVID's vacancy rates are decreasing to 1.2% in fiscal 2023, from 1.7% two years ago, with the average over the last three years around 1.4%, which we consider at par with the sector average.

We consider that VIVID's strong management and its solid business planning, which includes flexible development plans and extensive stress testing against key performance and financial indicators, means it can withstand external economic factors better than many peers. For instance, we consider that the group's relatively large proportion of development of homes for sale constrains its financial performance and exposes it to potential market volatility, fluctuating selling prices, and higher construction costs. That said, even though more than one-third of the group's adjusted operating revenues stem from the first tranche sales of shared ownership and outright sales units, we continue to project very stable adjusted EBITDA margins, underpinned by the group's solid management of sales risk.

In line with the sector, VIVID is investing in its existing stock to bring all its homes up to the Energy Performance Certificate (EPC) C level by 2030. Currently over 70% of its stock is at the EPC C level, which is above the sector average. Although we think this spend will weigh on the group's financial performance over the next two years, we understand that the group has received grants from the SHDF, which will mitigate the effects. This is part of management's proactive approach to lead the transition toward carbon neutrality, which is fully accounted for in its plans, as evidenced by its commitment to spending about £750 million to achieve net zero emissions by 2050.

We assess the regulatory framework under which registered providers of social housing in England operate as strong (for more information see "Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers," published June 8, 2021).

Financial profile: Remains strong despite increasing investments in existing homes and higher interest costs pressuring debt metrics

We expect VIVID's adjusted EBITDA margins to weaken from historically strong levels of 35%, as inflation exacerbates the cost of maintenance and repairs, and increased spending to meet enhanced requirements on existing stock. We estimate the adjusted EBITDA margins dropped to around 31% in fiscal 2023, when inflation exceeded rent increases, and the group's investments in existing homes increased significantly. We forecast the group's adjusted EBITDA margins to remain around 32% through fiscal 2026. This base case is underpinned by our assumption that rental income will increase faster than costs, that VIVID manages to maintain relatively solid margins in its development for sales activities and that continued investments in existing homes will be mitigated by grants from SHDF.

We continue to view VIVID's debt metrics as very solid but forecast the nonsales adjusted EBITDA interest cover weakening from very strong levels. Although the group has secured grant funding through its strategic partnership with Homes England, and lowered its new homes development aspirations, we still expect it will need to partly debt fund new home developments. We forecast a recovery from the relatively weak fiscal 2023, when the adjusted debt to nonsales EBITDA exceeded 20x, and think it will steadily improve through fiscal 2026 because the group's nonsales adjusted EBITDA will, in our view, increase more than its debt.

We forecast that higher interest rates than previously assumed will reduce VIVID's nonsales adjusted EBITDA interest coverage. At the same time, while some of the group's higher margin floating-rate debt facilities expire over the next two years, we assume VIVID would need debt funding for refinancing as well as to fund new home development. In our view, this would be at a higher level than its current average cost of debt. We therefore do not expect a material recovery in the group's adjusted nonsales EBITDA interest coverage but think it will remain at around 1.6x through fiscal 2026.

We assess VIVID's liquidity position as strong, with sources covering uses by about 1.6x in the next 12 months. This is based on our forecast of liquidity sources of close to £720 million (mainly cash and undrawn available facilities, cash from operations [adding back the noncash cost of sales], and proceeds from asset sales and grant funding) compared with liquidity uses of more than £455 million (primarily capital expenditure and interest and principal payments). We also consider that VIVID has a satisfactory access to external funding when needed.

Government-related entity analysis

We believe there is a moderately high likelihood VIVID would receive timely extraordinary government support in case of financial distress. This provides one notch of uplift from the stand-alone credit profile. As one of the RSH's key goals is to maintain lender confidence and low funding costs across the sector, we believe it is likely that the RSH would step in to try and prevent a default in the sector. We base this view on previous records of the RSH mediating mergers or arranging liquidity support from other registered providers in cases of financial distress.

Selected Indicators

Table 1

VIVID Housing Ltd.--Key statistics

	--Year ended March 31--				
Mil. GBP	**2022a**	**2023e**	**2024bc**	**2025bc**	**2026bc**
Number of units owned or managed	33,355	34,391	35,495	36,625	37,759
Adjusted operating revenue	297.4	326.9	361.0	419.2	417.5
Adjusted EBITDA	102.8	101.6	116.6	131.1	135.9
Nonsales adjusted EBITDA	85.9	77.7	96.0	110.4	117.1
Capital expense	188.8	253.8	308.8	332.8	337.3
Debt	1,404.7	1,577.8	1,660.2	1,700.4	1,822.4
Interest expense	45.8	51.4	65.2	67.7	70.7
Adjusted EBITDA/Adjusted operating revenue (%)	34.6	31.1	32.3	31.3	32.5
Debt/Nonsales adjusted EBITDA (x)	16.4	20.3	17.3	15.4	15.6
Nonsales adjusted EBITDA/interest coverage(x)	1.9	1.5	1.5	1.6	1.7

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

Ratings Score Snapshot

Table 2

VIVID Housing Ltd.

	Assessment
Enterprise risk profile	3
Industry risk	3
Regulatory framework	3
Market dependencies	3
Management and Governance	2
Financial risk profile	3

Table 2

VIVID Housing Ltd. (cont.)

	Assessment
Financial performance	3
Debt profile	4
Liquidity	3

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 Stable From Negative On Moderating Fiscal Risks; 'AA/A-1+' Ratings Affirmed, April 21, 2023
- U.K. Social Housing Borrowing 2023: On Pause, March 28, 2023
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings History: March 2023, March 27, 2023
- U.K. Social Housing Providers Set Their Sights On Cyber Risks, Dec. 16, 2022
- Non-U.S. Social Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022
- Inflation To Erode The Performance Of U.K. Public Finance Sectors, Nov. 29, 2022
- Bulletin: Cap On Rent Increases Is Consistent With Our Base Case For English Social Housing Providers, Nov. 17, 2022
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 2022
- Bulletin: Launch Of Rent Cap Consultation Adds Uncertainty To Creditworthiness Across

English Housing Sector, Sept. 1, 2022

- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021

Ratings List

Ratings Affirmed	
VIVID	
Issuer Credit Rating	A/Stable/--