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RATING ACTION COMMENTARY

Fitch Publishes Peabody Trust's 'A' Long-Term IDR; Outlook Stable

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Fitch Ratings - London - 01 Dec 2024: Fitch Ratings has published Peabody Trust's 'A' Long-Term Issuer Default Rating (IDR) and senior secured rating. The Outlook on the IDR is Stable.

Fitch views Peabody as a government-related entity (GRE) of the United Kingdom (AA-/Stable). Fitch has 'Strong expectations' of support from the state for Peabody. Combined with a Standalone Credit Profile (SCP) assessed at 'a-', which is three notches below the sovereign, this leads to a one-notch uplift for the IDR.

Continuing high demand for social and affordable housing and ongoing cash flow from rented properties continues to support Peabody's credit, despite a challenging economic environment. Fitch expects financial metrics to improve through the rating case, driven by deleveraging from disposal and improved EBITDA margins from merger efficiencies and closer links between cost and revenue increases.

KEY RATING DRIVERS

Support Score Assessment 'Strong expectations'

We have 'Strong expectations' of support from the UK government to Peabody, as reflected by 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, Peabody is not owned by the UK government due to its structure and status. In strict terms, it has no legal owner, with all surpluses reinvested to provide social housing. We view the regulatory framework for English social housing as robust, and the Regulator of Social Housing as maintaining sound control and tight monitoring of RPs.

Precedents of Support 'Strong'

Peabody consistently receives 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 or the regeneration of existing estates, rather than to finance debt or prevent default. Policy influence is supportive of the financial stability of RPs, with very few entering financial difficulties and none reaching a default. 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 major public service. A default of Peabody would have no immediate impact on the service but over the medium term could affect external financing that RPs rely on for maintenance capex and new investments. While other RPs could act as substitutes in the event of default by Peabody, reduced access to financing and subsequently diminished financial resilience would lead to a decline in medium-term service provision.

Contagion Risk 'N/A'

Default would have a minimal impact on the availability and 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 at large. However, it could raise questions about the role of the regulator and sponsor.

Standalone Credit Profile

Peabody's 'a-' SCP reflects the combination of a 'Stronger' risk profile and a financial profile assessed in the 'bbb' category

Risk Profile: 'Stronger'

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

Revenue Risk: 'Stronger'

Demand in the UK for social housing is high and sustained, and any change in the rents that RPs are able to charge is unlikely to materially affect demand. High demand is unlikely to be affected by economic pressures. Social housing is counter-cyclical to the UK economy, meaning that demand strengthens in a downturn.

Fitch assesses pricing as 'Stronger' despite a lack of flexibility in setting social and affordable rents. Peabody has flexibility over pricing from its non-social housing activity, which it uses to cross-subsidise the core business. Fitch believes the regulatory framework will maintain compensation for services at a level that supports the solvency of the sector. Social housing lettings generate 77% of Peabody's revenue, while non-social means and shared ownership account for the remainder.

Expenditure Risk: 'Stronger'

Peabody has well-identified cost drivers and low potential volatility in major items. The largest items in opex are staff (29%) and maintenance costs (26%), over which Peabody has control. It has no material supply constraints on labour or resources. Along with the wider sector, Peabody faces heavy cost pressures due to previously high inflation. UK inflation was at record highs in 2022 but has been falling since February 2023.

Peabody has a clear and documented capital planning process, with a phased approach to its development strategy and it monitors projects on a regular basis. It has limited required capex (building safety), and all other capex is flexible in timing and delivery. Peabody has invested about GBP276 million on building safety improvements since 2018 with additional budgeted. By the financial year ending 31 March 2024 (FY24), almost 80% of Peabody's existing homes had energy performance certificates of C or above.

Liabilities and Liquidity Risk: 'Stronger'

Peabody currently has around GBP4.8 billion total debt. It operates in a fully-developed financial market with full access to banks, debt capital markets and private placements. Around 75% of net debt is fixed rate, limiting exposure to fluctuations in the capital markets. Overall, Peabody has a strong debt profile with smooth and long-term repayment (weighted average life of debt is over six years) with relatively little short-term debt. There are currently no off-balance sheet risks.

The sector has general access to finance, with institutional investors and banks widely available. At end-FY24, Peabody had GBP1,198 million (2023: GBP1,608 million) undrawn accessible credit lines, with around GBP900 million from committed revolving credit facilities. It also held around GBP133 million in cash, providing adequate liquidity to support its medium-term business plan. Peabody has a similar covenant package across its debt portfolio to peers, including asset cover ratios and EBITDA interest coverage. Peabody sets internal thresholds for both of these metrics providing significant headroom against the covenant levels, which are met throughout its business plan.

Financial Profile 'bbb'

We expect Peabody's performance to improve from FY25, after net debt/EBITDA peaked in FY24 at around 14.5x. We do not view this level as representative of Peabody's underlying financial strength, and expect leverage ratios to improve below 11x by FY29.

Fitch expects net debt to remain stable at around GBP4.6 billion by FY29, with strategic disposals allowing for reinvestment in existing assets. The improvement in net debt/EBITDA will be driven by an expected improvement in EBITDA over the next five years, which we expect to average around GBP420 million. This will reflect social rents increasing in line with CPI +1% and costs being managed through the larger merged group and lower inflation than in recent years.

Derivation Summary

Peabody's 'a-' SCP is driven by a 'Stronger' risk profile and a 'bbb' financial profile, and comparison with peers in the sector. We consider its closest peers in the portfolio London & Quadrant Housing Trust (L&Q, A/Negative) and Clarion Housing Group Limited (Clarion, A+/Negative) due to size, location and economic challenges. Peabody has stronger historical performance than L&Q, with lower execution risk in terms of leverage improvement due to less reliance on large scale disposal of non-social assets. Peabody has weaker historical performance than Clarion, we expect them to have a similar improvement trajectory over the next five years.

We view Peabody as a UK GRE, with a support score of 20 points. This results in a bottom-up approach, with a one-notch uplift from the SCP to the Long-Term IDR of 'A'.

Short-Term Ratings

The Short-Term IDR has been assigned at the higher of two possible outcomes, 'F1+', as a result of the 'A' Long-Term IDR and strong liquidity metrics.

Debt Ratings

The senior secured debt rating is in line with the Long-Term IDR.

Issuer Profile

Peabody is one of the largest providers of social housing in the UK, with over 108,000 units owned and managed. It predominantly operates in London and has a core number of assets in both north and south counties around the capital.

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 rating case assumptions.

RATING SENSITIVITIES

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

A multi-notch downgrade of the sovereign to 'A', which Fitch currently views as unlikely, inability to improve net debt/EBITDA below 12x on a sustained basis or an adverse change to the assessment of the key rating factors could result in a downgrade.

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

A sustained improvement in net debt/EBITDA towards 10x in the medium term or a change in the assessment of the key rating factors.

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			
Peabody Trust	LT IDR	A Rating Outlook Stable	Publish	
	ST IDR	F1+	Publish	
	LC LT IDR	A Rating Outlook Stable	Publish	
	LC ST IDR	F1+	Publish	
senior secured	LT	A	Publish	
Peabody Capital No 2 plc				
senior secured	LT	A	Publish	
Peabody Capital plc				
senior secured	LT	A	Publish	
TCHG Capital plc				

VIEW ADDITIONAL RATING DETAILS

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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

Peabody Capital No 2 plc	UK Issued, EU Endorsed

Peabody Capital plc	UK Issued, EU Endorsed
Peabody Trust	UK Issued, EU Endorsed
TCHG Capital plc	UK Issued, EU Endorsed

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