Research Update:

U.K.-Based Housing Association Peabody Trust Ratings Affirmed at 'A-'; Outlook Negative

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Overview

- Peabody Trust (Peabody), a large London-based provider of social housing, will continue to face financial performance pressure due to investment in its existing homes.
- While we think Peabody is taking actions to mitigate this financial pressure, financial indicators will improve gradually from the currently weak position since the positive impacts may take time to materialize.
- We therefore maintained the outlook as negative. We also affirmed our 'A-' long-term issuer credit rating on Peabody.

Rating Action

On Nov. 15, 2024, S&P Global Ratings affirmed its long-term issuer credit rating on Peabody Trust at 'A-'. The outlook remains negative.

We also affirmed our long-term issuer credit ratings on Town & Country Housing Group at 'A-', because we consider it to be a core subsidiary of Peabody Trust.

At the same time, we affirmed our 'A-' issue ratings on the £1 billion senior secured and unsecured medium-term note program issued by Peabody Trust, as well as the senior secured debt issued by Peabody Trust, TCHG Capital PLC, and Peabody Capital No 2 PLC. We consider the latter two finance vehicles to be core subsidiaries of Peabody Trust.

Outlook

The negative outlook reflects our view that the cost-containing measures implemented by Peabody's management, which mitigate the pressure from elevated investments in existing homes, may not improve its financial metrics as we expect in the base case.

Downside scenario

We could consider lowering the ratings on Peabody if, over the next 24 months, management fails to achieve cost efficiencies and timely asset disposals, or if control over investment in existing homes becomes less efficient than we currently project, leading to margins stabilizing at less than 15% of revenues. Higher-than-anticipated debt funding for new home development, combined with lower S&P Global Ratings-adjusted non-sales EBITDA, could contain interest coverage well below 1x.

Furthermore, we could lower the rating if we revise downward our view of the likelihood of extraordinary support to Peabody from the U.K. government in the event of financial distress.

Upside scenario

We could revise the outlook to stable if, over the next 24 months, we notice Peabody's debt metrics gradually strengthening in line with our base case. Specifically, we would consider a stable outlook if management successfully reins in costs, resulting in a sustained improvement of nonsales adjusted EBITDA. Under this scenario, we would expect the group's nonsales adjusted EBITDA interest coverage to improve toward 1x.

Rationale

The rating affirmation reflects our expectation that the group's management actions will strengthen financial metrics. We think the group will increase rent that outpaces inflation and effectively control costs. We also expect the group will contain its development ambitions, allowing associated capital expenditure to stabilize in the coming 2-3 years. In addition, we forecast the group will be able to dispose of some uneconomic or non-core assets, which should generate additional cash to help reduce the group's debt funding need.

Enterprise profile: A strong market position and continued focus on traditional social housing activities support the credit metrics

Peabody is one of the largest housing associations in England. With more than 108,000 units in its portfolio across the more affluent regions of London and Southeast England, it should have more financial and operational resources than most peers to absorb external shocks and fund its investments. We think demand for its properties will remain high because its average general needs rent--about 47% of the prevailing market rent--is relatively low compared to that of peers. The strong demand is also evident in the group's average vacancy rate of 1.4% over the past three years, which is slightly below the sector average in England.

We expect Peabody will remain focused on the social and affordable housing letting sector, where revenue is more predictable and less cyclical than sales activities. In our view, the group will limit its exposure to market sales in tandem with its plan to reduce new home development. We project exposure to sales income, including that generated by joint ventures, will be limited to less than 25% of the group's adjusted revenue on average over the next two to three years.

We understand Peabody is continuing to implement measures to prevent financial metrics from deteriorating. However, these measures to mitigate the pressure on the group's financial indicators, mainly from investment in existing homes, have not fully aligned with our previous base-case assumptions. We think they will take time to materialize, and therefore, we forecast the recovery of the financial metrics will be delayed. This is compounded by Peabody's large presence in London, which has relatively higher exposure to high-rise buildings compared to peers in other parts of the country.

We assess the regulatory framework, under which registered social housing providers in England operate, as strong (for more information see "Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks," published Oct. 23, 2023, on RatingsDirect).

Financial profile: Management's mitigating actions should strengthen credit metrics, albeit slowly

Financial performance will remain subdued due to an elevated level of investment in existing homes, but we forecast a modest improvement. We anticipate the group will begin to reap some benefits from cost efficiencies resulting from the synergy effects of the merger with Catalyst Housing two years ago. Meanwhile, we expect the group will utilize the flexibility it has in its home investment program. We also estimate the group will receive funding to subsidize investments in asset quality, including the Building Safety Fund and the Warm Homes: Social Housing Fund, as well as recoveries from contractors. However, there is a likelihood these savings and funding could be delayed, which would protract the recovery projected in our base case.

We expect a gradual reduction in the debt burden due to a steadily strengthening of nonsales adjusted EBITDA and lower debt-funded capital expenditures. This is supported by our view that the group will develop fewer new homes, thereby reducing associated capital expenditures and limiting debt build-up. We also forecast the group's disposal program will provide additional funding for investments in existing and new homes, although some of the planned disposals are still in the early stages. Moreover, our expectation of lower interest rates should lead to a reduced interest payment burden. Yet, the recovery of debt metrics remains slow.

We think Peabody has strong liquidity. The group's liquidity sources cover its uses by approximately 1.7x in the next 12 months. We forecast liquidity sources of about £1.3 billion, which comprise cash, undrawn and available revolving credit facilities, asset sales, grant receipts, and cash from operations (adding back the noncash cost of sales). This will cover liquidity uses of about £780 million--mainly capital expenditure and debt service payments. At the same time, we believe Peabody retains strong access to external liquidity, when needed.

Government-related entity analysis

We think there is a moderately high likelihood that Peabody would receive timely extraordinary support from the U.K. government in the case of financial distress. This provides a two-notch uplift from the stand-alone credit profile. Since one of the key goals of the Regulator of Social Housing (RSH) is to maintain lender confidence and low funding costs across the sector, we think it is likely the RSH would intervene to try and prevent a default in the sector. We base this view on previous instances where the RSH has mediated mergers or arranged liquidity support from other registered providers in cases of financial distress, and we think this would also apply to Peabody.

Selected Indicators

Table 1

Peabody Trust--Financial statistics

	--Year ended Mar. 31--				
Mil. £	**2023a**	**2024a**	**2025bc**	**2026bc**	**2027bc**
Number of units owned or managed	107,449	108,823	108,731	109,214	109,754
Adjusted operating revenue	1,097.0	972.0	1,079.3	1,105.2	1,202.1
Adjusted EBITDA	135.0	132.0	156.0	185.6	213.6
Nonsales adjusted EBITDA	103.0	117.0	135.5	167.3	190.2
Capital expense	509.0	513.0	522.2	539.7	407.3
Debt	4,554.0	4,835.0	4,985.0	5,102.0	5,022.0
Interest expense	175.0	223.0	218.5	210.8	208.1
Adjusted EBITDA/Adjusted operating revenue (%)	12.3	13.6	14.4	16.8	17.8
Debt/Nonsales adjusted EBITDA (x)	44.2	41.3	36.8	30.5	26.4
Nonsales adjusted EBITDA/interest coverage(x)	0.6	0.5	0.6	0.8	0.9

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

Ratings Score Snapshot

Table 2

Peabody Trust--Ratings score snapshot

	Assessment
Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	2
Management and governance	4
Financial risk profile	4
Financial performance	5
Debt profile	6
Liquidity	2
Stand-alone credit profile	bbb
Issuer credit rating	A-

S&P Global Ratings bases its ratings on nonprofit social housing providers on the seven main rating factors listed in the table above. Our "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

Related Research

- The Autumn Budget Kicks Off A Funding Regime Revision For U.K. Public Sector Entities, Nov. 5, 2024
- U.K. Social Housing Providers' Financial Capacity Shrinks On Investment Needs, Nov. 4, 2024
- Non-U.S. Social Housing Providers Ratings Risk Indicators: Ratings Pressure Has Eased, Oct. 31, 2024
- Non-U.S. Social Housing Providers Ratings History: October 2024, Oct. 31, 2024
- Cyber Risk Brief: U.K. Public Sector Is Increasingly Under Threat, Oct. 24, 2024
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 18, 2024
- U.K. Social Housing Borrowing 2024: Borrowing capacity remains constrained, March 6, 2024
- European Housing Markets: Forecast Brightens Amid Ongoing Correction, Jan. 25, 2024
- Non-U.S. Social Housing Sector Outlook 2024: At A Turning Point?, Nov. 29, 2023
- Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks, Oct. 23, 2023
- U.K. Social Housing Providers' Credit Headroom Could Tighten If The Operating Environment Deteriorates, Oct. 4, 2023

Ratings List

Ratings Affirmed	
Peabody Trust	
Town & Country Housing Group	
Issuer Credit Rating	A-/Negative/--
Peabody Trust	
Senior Secured	A-

Ratings Affirmed	
Peabody Capital No 2 PLC	
Senior Secured	A-
TCHG Capital PLC	
Senior Secured	A-