Research Update:

U.K. Social Housing Provider Accent Group Downgraded To 'A'; Outlook Stable

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Overview

- Accent Group Ltd.'s ambitious development plan has meant higher capital expenditure (capex) than we previously forecast, taxing the group's debt and liquidity metrics through FY2024.
- The group has retained its focus on traditional housing activities and its solid interest coverage will support the rating.
- We are lowering to 'A' from 'A+' our long-term issuer credit rating on Accent.
- The stable outlook indicates that we expect higher debt to be offset by the group's focus on low-risk activities.

Rating Action

On July 20, 2021, S&P Global Ratings lowered to 'A' from 'A+' its long-term issuer credit rating on U.K. social housing provider Accent Group Ltd. The outlook is stable.

At the same time, we lowered to 'A' from 'A+' our issuer rating on Accent Capital PLC and our issue rating on the £350 million bond Accent Capital issued in 2019, of which £125 million has been retained. Accent Capital was set up for the sole purpose of issuing bonds and lending the proceeds to Accent Housing Ltd., and we view it as a core subsidiary of the group.

Outlook

The stable outlook indicates that we expect higher debt incurred to increase development will be offset by a boost in revenue from the new units.

Downside scenario

We could lower the rating on Accent if management deviated from its current strategy and became heavily reliant on sales activities. Not only would this increase the volatility of the group's surplus, it would also amplify the group's funding needs.

We could also lower the rating on Accent if we thought there was less likelihood of Accent receiving timely and sufficient extraordinary support from the U.K. government, through the Regulator of Social Housing (RSH), in the event of financial distress.

Upside scenario

An upgrade would depend on management taking a less aggressive view on development, reducing Accent's need for borrowing. Under this scenario, we would expect the group's debt, measured using adjusted EBITDA, to remain below 15x and its liquidity to show a structural improvement to above 1.75x.

Rationale

We base our downgrade of Accent on our expectation that funding its ambitious development plan will require it to undertake a larger increase in borrowing than we had previously forecasted. Higher capex will also weigh on liquidity, and thus on Accent's debt metrics, over the three-year rating horizon.

Profitability will be subdued by the group's need to invest heavily in its existing stock. We expect debt to nonsales EBITDA to remain above 20x in the financial year ending March 31, 2022 (FY2022) as the group catches up on maintenance that was delayed by the pandemic. Accent plans high levels of maintenance and capitalized repairs, which will keep EBITDA margins below 30% for the next three years. Over the past two years, the group has taken a proactive approach to asset management, reviewing replacement component life cycles, carrying out stock condition surveys, implementing a new software to validate planned decarbonization expenditure, and introducing a new repair and maintenance strategy. This strategy has boosted investment in its existing stock, squeezing margins. We expect that margins will recover slightly from FY2023 as the ramp-up in development, combined with an increase in rent of consumer price index (CPI) plus 1% counterbalances the rise in costs.

We believe there is a moderately high likelihood that Accent would receive extraordinary government-related support in case of financial distress. This provides a one-notch uplift from the stand-alone credit profile (SACP) for Accent. A key goal of the Regulator of Social Housing (RSH) is to maintain lender confidence and low funding costs across the sector, so we believe it likely that the RSH would step in to try to prevent a default in the sector. We base this view on the RSH's track record of mediating mergers or arranging liquidity support from other registered providers in cases of financial distress and think this would also apply to Accent.

The 'A' rating is underpinned by Accent's focus on traditional housing activities, operations in areas of strong demand and high market rents, and solid interest coverage.

We consider that Accent's areas of operations demonstrate favorable market dependencies--social rents represent around 60% of market rents and voids have averaged less than 1% FY2019-FY2021. The pandemic has led to a slight worsening of operational metrics, but we expect that the increase in voids will be temporary. Vacancies are likely to decline to historical levels of below 1%, which is below average for Accent's peer group. Accent owns and manages over 20,000 homes across North, East, and South England. Its key locations include Bradford, Peterborough, and Surrey Heath.

We expect Accent's core business will remain low-income social housing activities, which supports our view that it will have predictable revenue streams and low industry risk. We forecast that management will continue to develop units for sale over the forecast period, through shared ownership and outright sale. We expect these activities to remain limited, below 20% of turnover, given management's goal to focus on rental tenures.

We assess the regulatory framework under which registered providers of social housing in England operate as strong, underpinned by their public policy mandate to provide affordable homes. We also consider that the sector benefits from solid ongoing oversight by the RSH. These strengths are offset, in our view, by the relatively low levels of grant funding that providers in England receive for developing affordable homes. Instead, many providers in England develop homes for outright sale and use the proceeds as an alternative funding source. In our view, this exposes them to greater risks and volatility than providers in other regions. Providers in England are also subjected to negative intervention from the U.K. government, in the form of constraints on rent setting or additional spending responsibilities, imposed without providing adequate additional funding. This weighs on the regulatory framework assessment, in our view.

We view the group's development plan as ambitious. Accent aims to deliver 400 homes per year, or to increase its existing stock by 2% a year. Despite the large size of the program, we view management as experienced. It has the capabilities to deliver on the group's development ambitions. The group has slightly updated its development plan since last year, to reflect a slight reduction in units and a reprofiling following pandemic-related delays. In line with last year's plan, management views private sales as a noncore tenure--we expect only a handful of units will be developed for private sale over the forecast period.

We now expect the group will undertake additional borrowings in FY2022 and FY2024 to fund its development plan. As a result, its debt will be close to £600 million in FY2024; we previously expected that it would remain below £500 million. Accent's debt to nonsales adjusted EBITDA is forecast to peak at about 24x in FY2022. We anticipate Accent's interest coverage will remain solid, averaging above 1.75x across our forecast period. The group's bond issuance enabled the group to secure new debt at an attractive coupon, while using part of the proceeds to repay legacy debt that had a high average interest rate. This supports its debt to nonsales adjusted EBITDA ratio.

Liquidity

We now assess Accent's liquidity position as strong. Over the next 12 months, we expect sources of liquidity to exceed planned uses by about 1.53x, compared with 2.4x in our last review. With several committed facilities from a variety of lenders and its benchmark bond issuance, we view Accent's access to external liquidity as satisfactory.

We forecast that liquidity sources will comprise:

- Cash generated from continuing operations, forecast at £37 million;
- Cash and liquid investments of £99 million; and
- The undrawn, available portion of its committed bank facilities or bank lines maturing beyond the next 12 months, at £50 million.

We forecast that uses of liquidity will comprise:

- Capex of £100 million; and
- Interest and principal payments on debt of £21 million.

Key Statistics

Table 1

Accent Group Ltd.--Key Statistics

	--Year ended March 31--				
Mil. £	**2020a**	**2021e**	**2022bc**	**2023bc**	**2024bc**
Number of units owned or managed	20,721	20,448	20,626	21,102	21,537
Adjusted operating revenue	95.7	102.6	100.0	121.1	127.3
Adjusted EBITDA	20.5	33.0	21.7	31.7	35.1
Nonsales adjusted EBITDA	19.6	31.5	20.9	29.1	32.1
Capital expense	31.4	38.8	97.5	108.1	77.0
Debt	411.2	408.3	515.8	510.1	599.4
Interest expense	14.0	13.7	14.7	16.0	17.4
Adjusted EBITDA/Adjusted operating revenue (%)	21.7	32.1	21.7	26.2	27.6
Debt/Nonsales adjusted EBITDA (x)	20.7	13.0	24.7	17.5	18.7
Nonsales adjusted EBITDA/interest coverage(x)	1.4	2.3	1.4	1.8	1.8

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

Accent Group Ltd.--Ratings Score Snapshot

	Assessment
Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	2
Management and governance	3
Financial risk profile	3
Financial performance	4
Debt profile	3
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

- 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

- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 23, 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
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020

Ratings List

Downgraded; Outlook Action

	To	From
Accent Group Ltd.		
Accent Capital PLC		
Issuer Credit Rating	A/Stable/--	A+/Negative/--

Downgraded

	To	From
Accent Capital PLC		
Senior Secured	A	A+