Research Update:

U.K. Social Housing Provider Accent Group Ltd. 'A' Rating Affirmed; Outlook Stable

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Overview

- We expect that Accent Group Ltd.'s (Accent's) growing asset base and focus on traditional housing activities will, to some extent, help contain pressures stemming from rising inflation and the group's increasing investments in existing stock.
- We forecast that gradual recovery in S&P Global Ratings-adjusted EBITDA and favorable cost of debt will help the group to maintain solid interest coverage.
- We affirmed our 'A' long-term issuer credit rating on Accent. The outlook remains stable.

Rating Action

On July 18, 2022, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on U.K. social housing provider Accent Group Ltd. The outlook is stable.

At the same time, we affirmed our 'A' issuer rating on Accent Capital PLC and our 'A' issue rating on the £350 million bond Accent Capital issued in 2019. 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 reflects our view that a gradual recovery in adjusted EBITDA and increase in capital grant receipts to fund developments will somewhat offset the risks associated with inflationary pressures and the group's increasing investments in existing and new assets.

Downside scenario

We could lower the rating on Accent if we see a significant deterioration in the group's adjusted EBITDA margins due to higher costs than we currently anticipate over our base case. We could also lower the rating if debt-funded spending on development increases materially beyond our projections.

Upside scenario

We could raise the rating on Accent if the group structurally strengthens its financial performance through solid cost management while containing the debt funding of new developments.

Rationale

The rating affirmation reflects our view that Accent's prudent cost management and expanding asset base along with lower debt build-up will help it to absorb pressures arising from current headwinds in the sector and the group's need to invest in existing properties.

Accent owns and manages over 20,000 homes across North, East, and South England. We think that the group's relatively low social and affordable needs rents, which we estimate to be just under 60% of the market average rent across the area of operations, reflects strong affordability levels that support the high demand for Accent's properties. This high demand is also demonstrated by vacancy rates of about 1% on average over the past three years, which we estimate to be slightly below the sector's average of 1.5%.

We think that management demonstrates the skills and expertise required to manage Accent's diversity and scale of operations. The group's strategy continues to focus on increasing the quality of existing and new homes. This is evidenced by about 85% of the stock already meeting Energy Performance Certificate (EPC) C standards (or higher) and the group's commitment to deliver all new land-led development homes to EPC A standards.

We expect the group to complete close to 400 homes per year over our forecast horizon (financial year ending March 31, 2023, and financial year 2025). This represents a 2% increase in its existing asset base each year on average and is similar to our previous base case assumptions. Supporting this large development program is the higher than previously anticipated level of grant funding, secured in relation to the group's strategic partnership with Homes England. We understand that in accordance with the partnership requirements, the group reprofiled its tenure mix to substitute some of its affordable homes with shared ownership developments. Despite the increased proportion of shared ownership first tranche sale activities, we think the group's sales exposure will remain contained and will peak at just under 20% in financial year 2025.

We expect that Accent's growing asset base and increasing rental income will support its adjusted EBITDA margins to remain above 20% through our forecast period to financial year 2025. We project the stress on margins in financial year 2023 to be temporary, and largely driven by cost inflation materially exceeding the increase in rents. Going forward we expect the gap between cost and rent increases to narrow, owing to the favorable rent environment, supporting a gradual recovery in the group's financial performance.

We forecast Accent's debt intake to be lower compared with our previous base case, mainly owing to the additional grant receipts in relation to the Affordable Homes Program. However, we expect the pressure on adjusted EBITDA to result in the debt to adjusted non-sales EBITDA ratio remaining at around 20% on an average over our forecast horizon. The estimated spike in the debt ratio for financial year 2022 is driven by the issuance of the £125 million retained bond during the year. These drawdowns resulted in high levels of available cash as of March 31, 2022, strengthening the group's liquidity position.

We believe there is a moderately high likelihood that Accent 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 Regulator of Social Housing's (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 and think this would also apply to Accent.

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).

Liquidity

We assess Accent's liquidity position as very strong, with sources covering uses by 2.3x in the next 12 months. We expect the solid levels of cash and available bank facilities, in combination with increased grant funding, will strengthen the group's liquidity coverage. We view Accent's access to external liquidity as satisfactory.

Liquidity sources include:

- Cash and cash equivalents of about £149 million;
- Our forecast of cash from operations of about £31 million, adding back the noncash cost of sales;
- Available facilities maturing beyond the next 12 months of close to £93 million; and
- Grant funding and other inflows exceeding £16 million.

Liquidity uses include:

- Capital expenditure of about £105 million, including spend on units for sale; and
- Interest and principal repayments of close to £22 million.

Accent Group Ltd. --Key Statistics

	--Fiscal year ended March 31--				
Mil. £	**2021a**	**2022e**	**2023bc**	**2024bc**	**2025bc**
Number of units owned or managed	20,448	20,554	20,873	21,392	21,709
Adjusted operating revenue	102.6	103.9	109.7	120.6	147.0
Adjusted EBITDA	33.3	23.4	22.6	26.8	31.8
Non-sales adjusted EBITDA	31.8	21.8	21.1	25.2	27.4
Capital expense	37.0	42.7	105.9	101.3	98.5
Debt	408.2	485.3	479.6	515.8	548.5
Interest expense	13.7	14.8	15.6	16.0	17.0
Adjusted EBITDA/Adjusted operating revenue (%)	32.4	22.5	20.6	22.2	21.6
Debt/Non-sales adjusted EBITDA (x)	12.8	22.3	22.7	20.5	20.0
Non-sales adjusted EBITDA/interest coverage(x)	2.3	1.5	1.3	1.6	1.6

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

Ratings Score Snapshot

Accent Group Ltd.--Ratings Score Snapshot

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

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 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 22, 2022
- U.K. Social Housing Sector Borrowing Needs to Rise To Fund Investment In New Homes, March 31, 2022
- Social Housing Outlook 2022: Green Agenda Takes Root In Investment Plans, Nov. 23, 2021
- How U.K. Public Finance Sectors Fare Under Latest Spending Review, Nov. 11, 2021
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings List

Ratings Affirmed	
Accent Group Ltd.	
Accent Capital PLC	
Issuer Credit Rating	A/Stable/--
Accent Capital PLC	
Senior Secured	A