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Research Update:

U.K. Social Housing Provider Chelmer Housing Partnership 'A+' Rating Affirmed; Outlook Stable

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Table Of Contents

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Overview

- We believe that Chelmer Housing Partnership (Chelmer) shows a very strong enterprise profile underpinned by high housing demand in its areas of operation, as well as a strong financial profile reflected by high margins.
- The group has limited exposure to market sales activities and its response to changes in the sector is cautious, in our view.
- We are therefore affirming our 'A+' long-term rating on Chelmer.
- The stable outlook reflects our expectation that Chelmer will maintain strong profitability and control its debt level over the next two years, by keeping a moderate exposure to market sales activities.

Rating Action

On Nov. 18, 2016, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K. social housing provider Chelmer Housing Partnership (Chelmer). The outlook is stable.

At the same time, we affirmed our 'A+' issue rating on the £200 million bond, including £125 million already issued by Myriad Capital PLC, Chelmer's funding vehicle. Myriad Capital PLC was set up for the sole purpose of issuing bonds and lending the proceeds to Chelmer, and we view it as a core subsidiary of the Chelmer group.

Rationale

The affirmation is based on Chelmer's stand-alone credit profile (SACP), which we continue to assess at 'a+', underpinned by our view of Chelmer's very strong enterprise profile, and still strong financial profile.

The rating reflects the low industry risk, under which Chelmer operates, as well as its strong economic fundamentals, notably thanks to its geographic coverage. Chelmer is actually benefitting from infrastructure projects in its main area of operation, Chelmsford (Essex), and may benefit from a Crossrail extension in the medium term, making the area more attractive and supporting demand through stronger links with London. This translates into low vacancy rates of about 0.4% of net rental income in fiscal year 2016 (ended March 31).

We also see Chelmer's management's response to the recent changes in the sector as quite cautious, shown by the relatively low exposure to market sales activities. We think that the proportion of revenues stemming from nontraditional activities will not exceed 20% in our updated base case for 2017-2019, and that they will mostly take the form of shared ownership first-tranche sales and some market sales.

Overall, we believe that Chelmer's strategy is in line with market conditions and will continue to support its good operating performance.

Our assessment of Chelmer's financial profile as strong is supported by sound margins, which will stand at more than 40% in our updated 2017-2019 base case (in line with our former base case), thanks to efficient cost management and to a careful approach to riskier sales exposure. This is despite the negative impact of a cut in rents that will weigh on Chelmer's revenue flows over the next four years started April 1, 2016. We consider Chelmer has adequate financial policies in place that support the development program to build more than 300 new homes every year. The plan will allocate the majority of units to affordable rent and increase shared ownership, while charging only a limited number of units at market rents. In our base case, we foresee capital expenditures remaining important to support the updated development plan, funded by Chelmer's draw-down of the £75 million retained tranche of its 2013 bond issuance. The rating is constrained by Chelmer's high leverage in comparison with the value of its assets (a loan-to-value ratio at 71% in fiscal 2016) and its EBITDA as per our updated base case (adjusted debt to EBITDA of about 17x on average over the next three years).

Our assessment that Chelmer benefits from a moderately high likelihood of extraordinary support from the U.K. government (unsolicited AA/Negative/A-1+), working through the Homes and Communities Agency, in the event of financial distress, has a neutral impact on the rating.

In accordance with our criteria for government-related entities, our view of a moderately high likelihood of extraordinary government support is based on our assessment of Chelmer's important role for the U.K. government and its public policy mandate, as well as its strong link with the U.K. government, demonstrated by the government's track record of providing strong credit support in certain circumstances.

Liquidity

We still view Chelmer's overall liquidity position as very strong, notably thanks to the available £75 million retained tranche of the bond issued in 2013. We think sources of liquidity will cover uses by over 2.5x over the next 12 months. Other liquidity sources include cash from operations and proceeds from asset sales. Liquidity uses of about £52 million are comprised of expected capital expenditures to support the development program and interest payments.

Chelmer had negative exposure on its derivatives as of Oct. 31, 2016, which is still comfortably mitigated in our view by excess collateral and Chelmer's ability to provide additional properties or cash as security, if required.

Outlook

The stable outlook reflects our expectation that Chelmer will continue to achieve strong profitability and maintain its debt to EBITDA under 20x over the next two years. It also reflects our expectation that Chelmer will limit its exposure to market sales activities and therefore also the volatility risks associated with market sales activities, and will continue to benefit from strong economic fundamentals.

We could lower our rating on Chelmer if we saw evidence that debt to EBITDA was above 20x, associated with EBITDA margins sustainably below 40%. This could happen if operating performance was weaker than we expected, for example, due to more significant capital spending to fund the development program than we forecast in our base case, owing to delayed results.

We could raise the rating if Chelmer strengthens its operating performance and sustainably achieves margins above 50%, as well as lower debt levels. This would happen if revenues and margin growth were higher than we currently anticipate in our base case.

However, we consider both our upside and downside scenarios as unlikely at this stage.

Chelmer Housing Partnership Financial Statistics

	--Year ending March 31--				
('000 £)	**2015a**	**2016a**	**2017bc**	**2018bc**	**2019bc**
Number of units	8,149	8,396	8,650	8,693	8,772
Vacancy rates (% of net rental income)	0.52	0.36	0.66	1.03	1.04
Arrears (% of net rental income)*	1.2	1.2	N.A.	N.A.	N.A.
Revenues	47,541	51,333	57,800	56,697	56,779
Share of revenues from nontraditional activities (%)	9.1	12.3	19.4	16.4	16.9
Operating expense	31,083	32,516	43,731	36,901	36,983
EBITDA§	20,960	24,671	20,054	24,046	24,342
EBITDA/revenues (%)	44.1	48.1	34.7	42.4	42.9
Interest expense	14,362	14,421	14,411	16,825	15,833
Debt/EBITDA (x)	17.0	14.1	18.0	17.5	16.3
EBITDA/interest coverage (x)†	1.4	1.7	1.4	1.4	1.4
Capital expense	29,396	42,944	34,694	36,931	34,102
Debt	357,300	347,861	361,166	420,636	395,829
Housing properties (according to balance-sheet valuation)	451,338	490,481	507,449	524,318	544,466
Loan to value of properties (%)	79.2	70.9	71.2	80.2	72.7
Cash and liquid assets	49,180	31,389	2,000	2,000	3,405

*Current arrears §Adjusted for capitalized repairs. †Including capitalized interest. a--Actual. bc--Base case: reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Related Criteria And Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Criteria - Governments - General: Methodology For Rating Public And Nonprofit Social Housing Providers - December 17, 2014
- General Criteria: Group Rating Methodology - November 19, 2013
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- U.K. Social Housing Risk Indicators - November 9, 2016

Ratings List

	Rating	
	To	From
Chelmer Housing Partnership		
Issuer Credit Rating		
Foreign and Local Currency	A+/Stable/--	A+/Stable/--
Senior Secured		
Local Currency[1]	A+	A+
Myriad Capital PLC		
Senior Secured		
Local Currency[1]	A+	A+

[1] Dependent Participant(s): Bank of New York Mellon (London Branch) (The)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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