

Research Update:

# U.K.-Based Housing Association Paragon Asra Housing Ltd. Assigned 'A' Rating; Outlook Stable

June 19, 2020

## Overview

- Paragon Asra Housing Ltd. (PA Housing) benefits from a very strong enterprise profile, because it operates a high-quality asset base in areas of high demand for its properties, with moderate exposure to development-for-sale activities.
- We expect the group's ambitions to develop 5,700 social rent, affordable rent, and shared ownership units by 2027 will increase its debt burden over the forecast period.
- We are assigning our 'A' long-term issuer credit rating to PA Housing.
- The stable outlook reflects our expectation that management will adequately navigate COVID-19's impact, while maintaining a moderate exposure to shared ownership activities.

### PRIMARY CREDIT ANALYST

**Celia Franch Lopez**  
London  
+ 44 20 7176 0100  
celia.franch\_lopez  
@spglobal.com

### SECONDARY CONTACT

**Karin Erlander**  
London  
(44) 20-7176-3584  
karin.erlander  
@spglobal.com

## Rating Action

On June 19, 2020, S&P Global Ratings assigned its 'A' long-term issuer credit rating to U.K.-based social housing association Paragon Asra Housing Ltd. (PA Housing). The outlook is stable.

We also assigned our 'A' issue rating to the £250 million senior secured debt issued by PA Housing's funding vehicle, Paragon Treasury PLC.

## Rationale

Paragon Asra Housing Ltd. was legally formed in 2017 through the amalgamation of Paragon Community Housing, Asra Housing Association, and Leicester Housing Association. Paragon's roots were in a stock transfer from Elmbridge Borough Council (Surrey), and Asra was created as a black and minority ethnic organization. PA Housing maintains its diverse ethnic roots in both the population it serves and the composition of its staff and board. The group owns and manages about 23,000 properties for social and affordable housing, with a geographical focus on three regions: the East Midlands, London, and Surrey. Following the amalgamation, the group carried out a stock rationalization strategy to consolidate its presence in the East Midlands, disposing of 800 peripheral units. We expect that the group's new development will be mostly in London and

Surrey.

The 'A' rating is underpinned by strong demand for the group's properties; a focus on low-risk traditional housing activities while maintaining moderate exposure to development-for-sale activities; and a very strong asset quality.

The 'A' rating on PA Housing incorporates one notch of uplift from the stand-alone credit profile (SACP) reflecting our view that there is moderately high likelihood that the entity would receive extraordinary support in case of financial distress. PA Housing's primary purpose is to provide affordable homes, supporting important policy objectives of the U.K. government. We consider that the Regulator of Social Housing (RSH), a government agency, regulates PA Housing to promote a viable, efficient, and well-governed social housing sector and maintain lender confidence and low funding costs across the sector. It is therefore our view that the RSH would step in to prevent a default in the sector, based on its track record of being willing and able to provide extraordinary support on a timely basis.

PA Housing benefits from strong demand for its properties in its areas of operations, with average social rents standing at 58% of market rent and vacancy rates remaining below 1.5% over the past three years. However, we expect the COVID-19 pandemic to reduce its rent collection levels, as about 45% of the group's tenants are self-funders, not on housing benefits, and consequently more exposed to labor market dynamics. We factor into our base-case scenario a temporary increase in arrears with some bad debts materializing in fiscal year (FY) ending March 2021. However, we still expect that the group's gross arrears position will remain below most London-based peers.

We expect the group will ramp up development over the forecast period of FY2021-FY2023. Following the amalgamation in 2017, the group established the goal of developing 5,700 units over the next 10 years in its core areas of operations. Despite COVID-19-related delays that we forecast will slow down development delivery and expenditure in FY2021, we expect the group will deliver on average approximately 600 units per year over the next three years. We expect that 60% of the development will be for social and affordable rental tenures and 40% will be for shared ownership.

In our view, PA Housing's exposure to development-for-sale activities (shared ownership) will increase over the rating horizon, but remain moderate. During FY2021-FY2023, we expect exposure to sales will increase and average 17.6% of total revenues, peaking at 23% of exposure in FY2023. The group's internal golden rules points to its aim of containing exposure to sales activities below 25% of turnover. We expect that management will respect this golden rule, and continue to limit the group's exposure to sales. Management does not include outright market sales as a core tenure in its plan.

We view PA Housing's management team as having extensive experience in the social housing sector, with a strong focus on customer experience. Management is focused on increasing customer satisfaction by implementing initiatives to have a more proactive approach to its services and repairs, and investing in IT and digitalisation. We view the group's development plan as ambitious, but we note that the overall strategy is aligned with management's capabilities.

We expect profitability to remain subdued in FY2021 and FY2022-- with S&P Global Rating-adjusted EBITDA margins trending toward 30% over this period--and to recover in FY2023. Our COVID-19 rent-loss assumption, expected increased expenditure on fire safety compliance works, and weakening margins on shared ownership sales will create this temporary pressure. We forecast higher compliance spend, with a focus on fire safety and cladding, will hamper profitability over the next two years. We are also incorporating in our base case our expectation that house prices will decrease and remain depressed (see "Government Job Support Will Stem European Housing Market Price Falls," published May 15, 2020) which will weigh on the group's

operating margins for shared ownership activities. These pressures will be partially offset by the CPI +1% rent increase that became effective in April 2020, and the group's ongoing development, as it continues to add more rental units to its stock. We expect margins to trend toward 35% at the end of the forecast period.

We anticipate that debt will increase over the forecast period, to fund the group's development ambitions. The group has £800 million of drawn debt, and we expect that the nominal debt figure will increase toward £1 billion by FY2023. We expect that debt to EBITDA will remain above 15x across the forecast period, due to the increasing debt burden and the group's subdued profitability. We expect interest coverage to remain strong, but also suffer a similar weakening trend, thanks to the group's lower profitability expectations, especially in FY2021. In our view, income from nonsales activities will continue to comfortably cover interest costs through 2023 (1.3x on average for FY2021-FY2023).

Underpinning our assessment of the financial profile is our neutral assessment on financial policies. We would like to observe some track record of liquidity management over the forecast period, as development and consequent capital expenditure (capex) ramps up. Furthermore, we would like to see how the group's appetite for debt progresses and how it manages this debt accumulation.

## **Liquidity**

We assess PA Housing's liquidity position as strong, supported by high levels of committed undrawn bank facilities. We expect sources of liquidity to exceed planned uses by about 1.48x over the next 12 months. We continue to view PA Housing's access to external liquidity as satisfactory.

We expect liquidity sources will comprise:

- Forecast cash generated from continuing operation: £49 million;
- Cash and liquid investments: £40 million;
- Proceeds from asset sales: £7 million;
- The undrawn, available portion of committed bank facilities or bank lines maturing beyond the next 12 months, and which can be drawn: £181 million; and
- Expected ongoing cash injections from a government or group member as appropriate: £12 million.

We expect uses of liquidity will comprise:

- Expected capex: £135 million; and
- All interest and principal payable on short- and long-term debt obligations coming due: £61 million.

## **Outlook**

The stable outlook reflects our view that PA Housing will adequately manage COVID-19 headwinds, while maintaining a moderate exposure to development-for-sale activities, in line with management's rule of keeping exposure below 25%.

We could lower the ratings on PA Housing should its strategy deviate to incorporate more sales activities such that they represented more than one-third of revenue, as we would view the

enterprise profile as bearing more risk. Under such a scenario, we would also likely observe a worsening of the group's debt-coverage metrics. We could also lower the ratings should the fallout from COVID-19 be more severe than we forecast, with asset quality worsening to reflect higher voids and arrears.

Conversely, we could raise the ratings if we saw a structural improvement of the group's financial profile. In such a scenario, we would expect an intrinsically stronger liquidity position such that sources cover uses by 2x and debt coverage metrics remain below 15x.

## Key Statistics

Table 1

### Paragon Asra Housing Ltd. Selected Financial Indicators

(Mil. £)	--Year ended March 31--				
	2019a	2020e	2021bc	2022bc	2023bc
Number of units owned or managed	23,059	23,292	23,679	24,261	25,056
Revenue§	154.2	144.5	155.7	185.7	208.1
Share of revenue from sales activities (%)	7.4	5.6	11.1	18.6	23.1
EBITDA§†	54.4	43.8	45.9	59.0	71.5
EBITDA/revenue §†(%)	35.3	30.3	29.5	31.8	34.4
Capital expense†	47.9	114.1	130.2	147.0	149.2
Debt	709.1	801.9	926.1	1,021.7	1,080.6
Debt/EBITDA §†(x)	13.0	18.3	20.2	17.3	15.1
Interest expense*	26.7	30.1	34.1	38.1	41.0
EBITDA/interest coverage§†* (x)	2.0	1.5	1.3	1.5	1.7
Cash and liquid assets	54.4	43.7	20.6	11.8	10.1

§Adjusted for grant amortization. †Adjusted for capitalized repairs. \*Including capitalized interest. 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

### Paragon Asra Housing Ltd.

Industry risk	2
Economic fundamentals and market dependencies	3
Strategy and management	3
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	4
Debt profile	3
Liquidity	3

Table 2

**Paragon Asra Housing Ltd. (cont.)**

Financial policies	3
Financial profile	4

S&P Global Ratings bases its ratings on non-profit social housing providers on the eight main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, summarizes how the eight factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating. For social housing providers generating more than a third of its consolidated revenues from open market sales, we also refer to the "Key Credit Factors For The Homebuilder And Real Estate Developer Industry."

**Related Criteria**

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, Dec. 17, 2014
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

**Related Research**

- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 24, 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
- U.K. Social Housing Ratings History: February 2020, March 3, 2020
- Why Most Rated U.K. Social Housing Providers Are At Home In The 'A' Category, Dec. 3, 2019
- Global Social Housing Ratings Score Snapshot: December 2019, Dec. 2, 2019
- Global Social Housing Risk Indicators: December 2019, Dec. 2, 2019

**Ratings List**

**New Rating; Outlook Action**

**Paragon Asra Housing Ltd.**

Issuer Credit Rating      A/Stable/--

**New Rating**

**Paragon Treasury PLC**

Senior Secured              A

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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](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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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