Research Update:

U.K.-Based Paradigm Housing Group Ltd. Assigned 'A+' Rating; Outlook Stable

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Overview

- We expect Paradigm Housing Group Ltd. to focus on developing affordable housing in the south east of the U.K., with moderate exposure to development for sale activities.
- The group's financial performance is set to weaken to accommodate increasing investments in the energy efficiency of the group's existing stock, but we think it will remain solid.
- The group's planned refinancing will strengthen interest cover and support its very strong liquidity position.
- We assigned our 'A+' long-term issuer credit rating to Paradigm Housing Group Ltd.
- The stable outlook reflects our view that Paradigm should be able to deliver the development and investments as per our base-case scenario without undue pressure on the group's credit metrics.

Rating Action

On May 10, 2021, S&P Global Ratings assigned its 'A+' long-term issuer credit rating to Paradigm Housing Group Ltd. The outlook is stable.

Rationale

Our 'A+' rating is underpinned by the group's focus on affordable development, strong demand for the group's units stemming from its geographical footprint, and its excellent asset quality. Increasing investments in existing stock will put pressure on margins, but we expect profitability will remain strong, above 30% adjusted EBITDA margins over the forecast period. Paradigm also benefits from very strong liquidity and solid interest coverage of over 1.5x, which we expect will be strengthened following the group's planned refinancing.

As with other English housing associations, we believe there is a moderately high likelihood that Paradigm would receive extraordinary support from the government in case of financial distress. As such, we apply one notch of uplift to the stand-alone credit profile to derive the long-term

issuer credit rating. Paradigm'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 Paradigm 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 record of being willing and able to provide extraordinary support on a timely basis.

Paradigm manages more than 15,000 homes in the south east of England, with a focus on social and affordable rental accommodation. In our view, Paradigm operates in a strong market, benefiting from high demand for social housing and shared ownership in its core geographic areas of Buckinghamshire, Bedfordshire, and Hertfordshire. This region remains one of the most dynamic regions of England in terms of economic fundamentals, such as the ratio of social rent to market rent, and house price growth. The strong demand for social housing in its area of operation supports the group's high operating margins from traditional lettings activities.

We think a small increase in short-term arrears due to the pandemic will be mostly recoverable, and consider the residual rent losses as a one-off event. We expect Paradigm's gross arrears to remain moderate compared to peers' due to the group's strong position pre-pandemic. Paradigm demonstrates very strong operational performance, with vacancy rates below 0.7% of total rent and service charges receivable over the three years spanning the financial year ending March 31, 2018 (FY2018) to FY2020.

The group is expanding its stock base through new development in its core geographies, with an aim to deliver 2,250 new homes over the next five years. Successful execution of its development plan will support future EBITDA generation at a time of increasing maintenance and repairs expenditure. Management is targeting a 50/50 mix of affordable rental and shared ownership units in its development pipeline. Demand for Paradigm's shared ownership products remains strong, with first-tranche sales achieving operating margins of 31% over FY2020. We note that Paradigm temporarily scaled down development for sales following the onset of the pandemic, but we expect sales exposure will increase toward 20% of turnover from FY2024. We expect revenue from these activities will increase but remain moderate, at less than one third of total revenue. We think management's extensive expertise and robust risk management standards balance the volatility introduced by the group's development for sales activities.

We expect Paradigm will continue to report strong financial performance over the coming years, but that S&P Global Ratings' adjusted EBITDA margins will drop to below 40% as a result of the group's increasing investments in its existing stock and exposure to lower-margin sales activities. Paradigm's business plan incorporates £375 million of expenditure over the next 30 years to improve energy efficiency and work toward achieving carbon neutrality, while also employing an asset management strategy to divest or regenerate rental units that perform poorly. Over time, we think these investments will enable the group's homes to meet future consumer, environmental, and construction regulations, reducing both enterprise and financial risks in the longer term.

We forecast that debt will increase to fund development of new affordable homes and increasing investments in existing homes, but that interest coverage will remain solid following the group's planned refinancing. We now expect debt to EBITDA to increase toward 18x over the forecast period, compared with historical levels of below 15x. We expect interest coverage will stay solid, remaining above 1.5x across FY2022-FY2024, as Paradigm's planned refinancing will lower the group's cost of debt.

Liquidity

We view Paradigm's liquidity position as very strong, and think it will remain as such following the

group's refinancing. We assess the current sources-to-uses liquidity ratio at 2.7x, and we expect it will remain solid above 2x over the next two years. The group's very strong liquidity is supported by its high level of undrawn bank facilities and its ability to generate cash consistently in our base case. We view Paradigm's access to external liquidity as satisfactory.

Paradigm's current sources of liquidity are:

- Adjusted internal cash flow generation for the next 12 months of £57 million;
- Cash and liquid investments of £38 million;
- Proceeds from asset sales of £10 million;
- The undrawn part of its contracted and secured bank facilities maturing beyond 12 months, amounting to £182 million; and
- Government grants of about £2 million.

The company's current uses of liquidity are:

- Expected capital expenditure adjusted for cost of sales and capitalized repairs, amounting to £68 million; and
- Interest and principal repayment of £36 million.

Outlook

The stable outlook on Paradigm reflects our view that the group should be able to deliver the development and investments assumed under our base case without undue pressure on the group's credit metrics.

Downside scenario

We could lower the rating on Paradigm should the group's development program require more debt funding than we currently anticipate. We could also lower the rating should its development for sale strategy deviate materially from our base-case scenario. We consider that this could result in proceeds from market sales representing more than one third of revenue, while putting more pressure on the group's profitability.

Upside scenario

An upgrade would depend on management moving toward a more risk-averse strategy, reducing its development ambitions, which we think would result in a smaller intake of future new debt.

Key Statistics

Table 1

Paradigm Housing Group Ltd. -- Key Statistics

	--Year ended March 31--				
(Mil. £)	**2020a**	**2021e**	**2022bc**	**2023bc**	**2024bc**
Number of units owned or managed	15,215	15,449	15,675	15,982	16,351

Table 1

Paradigm Housing Group Ltd. -- Key Statistics (cont.)

	--Year ended March 31--				
(Mil. £)	2020a	2021e	2022bc	2023bc	2024bc
Revenue*	121.25	116.07	113.75	120.27	137.40
Share of revenue from sales activities (%)	20.96	13.55	11.56	10.51	17.82
EBITDA*§	51.24	49.76	46.59	45.98	50.37
EBITDA/revenue*§(%)	42.26	42.87	40.96	38.23	36.66
Capital expense§	46.96	31.90	68.04	95.93	107.79
Debt	741.67	721.18	773.32	833.51	891.01
Debt/EBITDA*§(x)	14.48	14.49	16.60	18.13	17.69
Interest expense†	32.51	31.65	30.08	29.98	31.75
EBITDA/interest coverage*§†	1.58	1.57	1.55	1.53	1.59
Cash and liquid assets	19.56	38.16	13.91	18.11	23.90

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

Ratings Score Snapshot

Table 2

Paradigm Housing Group Ltd. - Ratings Score Snapshot

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Strategy and management	3
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	4
Debt profile	3
Liquidity	2
Financial policies	3
Financial profile	3

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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- 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
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 23, 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
- 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

Ratings List

New Rating; Outlook Action	
Paradigm Housing Group Ltd.	
Issuer Credit Rating	A+/Stable/--