

RatingsDirect®

Research Update:

U.K.-Based The Guinness Partnership Outlook Revised To Negative; Rating Affirmed At 'A+'

Primary Credit Analyst:

Ratul Sood, CFA, London +44 (0) 20 7176 6536; ratul.sood@spglobal.com

Secondary Credit Analyst:

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

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

Research Update:

U.K.-Based The Guinness Partnership Outlook Revised To Negative; Rating Affirmed At 'A+'

Overview

- With U.K. government grants to housing associations still low, we understand that The Guinness Partnership is set to increase development for sale on the open market and via shared ownership. These activities, in our view, carry higher risks than traditional social-housing activities.
- The rating continues to be supported by our view of Guinness' enterprise and financial risk profiles as strong, and the moderately high likelihood that the housing association would receive extraordinary government support if needed.
- We are revising the outlook to negative, and affirming the long-term rating on Guinness at 'A+'.
- The negative outlook mirrors the outlook on the U.K. government rating. We could lower the rating if we downgraded the U.K. We could also lower the rating if Guinness' intrinsic creditworthiness weakened as a result of expansion into nontraditional activities.

Rating Action

On Nov. 29, 2016, S&P Global Ratings revised its outlook on U.K.-based housing association The Guinness Partnership to negative from stable. We affirmed the long-term issuer credit rating at 'A+'.

At the same time, we affirmed our long-term issue rating on Guinness' senior secured debt of £250 million at 'A+'.

Rationale

The outlook revision reflects Guinness' expansion into nontraditional activities, particularly development for outright sales and shared ownership. These activities show more volatile demand than traditional social housing and (in the case of outright sales) are more cyclical as a source of earnings. We have revised downward our assessment of Guinness' economic fundamentals because revenues from nontraditional activities are now sustainably set to exceed 25% of total revenues (the figure was about 30% for the financial year ended March 31, 2016). This has led us to revise Guinness' stand-alone credit profile downward to 'a' from 'a+'.

The 'A+' rating on Guinness also reflects our continued assessment of Guinness' moderately high likelihood of receiving extraordinary support from the U.K. government, working through the Homes and Communities Agency (HCA), which results in one-notch uplift to the SACP.

In accordance with our criteria for government-related entities (GREs), we base our view of the likelihood of extraordinary government support on our assessment of Guinness' important role for the U.K. government and its public-policy mandate, and

its strong link with the U.K. government. The U.K. government has a track record of providing extraordinary support to the sector in case of distress.

We consider traditional social housing--i.e., submarket rental activities--to be low risk globally as they are typically characterised by high and stable demand, even during economic downturns. However, as Guinness expands its exposure to nontraditional activities such as development for sale and shared ownership, which now account for about 30% of total revenues as of financial year (FY) 2016, its demand risk from such activities increases. We factor this into our assessment of its economic fundamentals and market dependencies. Guinness' stock is geographically diversified, with a strong presence in the South East and the North, which provides revenue diversity and helps reduce risks. The average annual population, based on weighted average of Guinness stock, has been consistently growing at a rate of 0.7% per year, slightly lower in the North than the South East.

Our assessment of strategic management factors in Guinness' very robust and detailed business planning and our view of its experienced management team. Management demonstrates a strong understanding of the changing social housing landscape in the U.K., and has clearly outlined mitigating steps Guinness could take if the environment were to deteriorate. We take a positive view of management's openness to engaging external consultants to identify and realize efficiencies in the organisational structure. Guinness is on course to achieve £10.5 million in efficiency savings by FY2017 against its £15 million target by FY2018. That said, the large increase in development-for-sale activities--by 2019 sales receipts are expected to form about 35% of total revenues--weighs on our assessment. In addition, although we understand management is taking steps to increase rent collection, current arrears continue to be slightly higher than those of rated peers at close to 4.5% as of FY2016.

Guinness' stock is of exceptional quality, in our view. The stock is relatively modern, with an average age of 35 years, and has low vacancy rates of about 1.1% on average over the last three years. We also take a positive view of Guinness's number of total units owned and managed, which exceeds 60,000.

Group turnover increased by about 17% to £426 million in FY2016, predominantly driven by increased revenues from properties sold on the open market. Adjusted EBITDA also increased to a less pronounced extent, reaching 34% in FY2016 from 31% in FY2015. Our expectation is that the EBITDA margin will remain marginally above 30% over the base case to FY2019 despite pressure from welfare reforms and involvement in lower-margin development-for-sale activities. Beyond our base-case horizon of two years, we anticipate a slight weakening in financial performance as Guinness further expands into nontraditional activities.

Due to a combination of marginally lower total debt and higher EBITDA, the ratio of debt to EBITDA has improved to 9.5x as five-year average to FY2019, from about 11x previously. At the same time, we expect EBITDA interest coverage to remain comfortably above 1.5x, as it is currently at about 2x over our base case. The current development plan is fully funded via internal cash and committed facilities, but the debt-to-EBITDA ratio could go above the 10x threshold if there is an

increase in borrowing or Guinness' operating performance is weaker than anticipated in the coming years. We view the high level of unencumbered assets of about £880 million as an additional layer of security (although monetizing such assets could require regulatory and lender consents).

Liquidity

Our assessment of very strong internal liquidity is based on cash coverage, with sources of cash of about £490 million covering cash uses of £250 million by about 2x over the next 12 months. The sources of cash include £380 million of undrawn credit facilities. The undrawn credit facilities (including the £100 million retained bond) are fully secured and available at short notice.

The uses mainly comprise £114 million of committed capital expenditure and £100 million of debt service. We believe Guinness has satisfactory access to external liquidity, having contracted revolving lines from nine major banks and through its access to deep and liquid debt capital markets in the U.K.

Outlook

The negative outlook on Guinness reflects the outlook on the U.K. We would lower the ratings over the next 24 months on Guinness if we were to downgrade the U.K. This would result in us removing the one-notch uplift we currently factor into the rating on Guinness for potential extraordinary government support.

We could also lower the rating if Guinness' operating performance was adversely affected by expansion into nontraditional activities, which pose higher risks and operate at lower EBITDA margins. Specifically, we could lower the ratings if financial performance weakens such that EBITDA margins fall below 30% of revenues on average, and liquidity weakens as Guinness draws on committed facilities.

We could revise the outlook to stable if, over the next 24 months, we revised the outlook on the U.K. to stable and at the same time there is no deterioration in Guinness' intrinsic creditworthiness.

The Guinness Partnership Financial Statistics

| ('000 £) | --Year Ended 31-Mar-- | | | | |
|--|-----------------------|---------|---------|---------|---------|
| | 2015a | 2016a | 2017bc | 2018bc | 2019bc |
| Number of units | 60,216 | 60,671 | 62,553 | 62,929 | 63,802 |
| Vacancy rates (% of net rental income) | 0.9 | 1.1 | 1.4 | 2.0 | 2.0 |
| Arrears (% of net rental income)* | 3.5 | 4.6 | 4.0 | 4.5 | 4.9 |
| Revenue | 350,400 | 412,700 | 417,993 | 314,156 | 505,476 |
| Share of revenue from non-traditional activities (%) | 24.5 | 29.7 | 28.8 | 7.8 | 41.2 |
| Operating expense | 264,100 | 301,900 | 300,421 | 225,368 | 381,620 |
| EBITDA§ | 107,000 | 138,400 | 136,459 | 111,117 | 150,129 |
| EBITDA/revenue (%) | 30.5 | 33.5 | 32.6 | 35.4 | 29.7 |

The Guinness Partnership Financial Statistics (cont.)

| ('000 £) | --Year Ended 31-Mar-- | | | | |
|---|-----------------------|-----------|-----------|-----------|-----------|
| | 2015a | 2016a | 2017bc | 2018bc | 2019bc |
| Interest expense | 57,800 | 62,600 | 61,906 | 66,070 | 77,334 |
| Debt/EBITDA (x) | 10.4 | 8.0 | 8.2 | 11.6 | 9.1 |
| EBITDA/interest coverage (x)† | 1.9 | 2.2 | 2.2 | 1.7 | 1.9 |
| Capital expense | 158,800 | 126,000 | 74,929 | 143,192 | 151,263 |
| Debt | 1,115,200 | 1,109,188 | 1,125,042 | 1,289,783 | 1,361,755 |
| Housing properties (according to balance-sheet valuation) | 2,723,100 | 2,792,500 | 2,839,538 | 2,962,905 | 3,093,251 |
| Loan to value of properties (%) | 41.0 | 39.7 | 39.6 | 43.5 | 44.0 |
| Cash and liquid assets | 61,700 | 41,100 | 80,764 | 35,114 | 37,065 |

*Current arrears §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.

Related Criteria And Research

Related Criteria

- General Criteria: Guarantee Criteria - October 21, 2016
- 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: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative On Brexit Uncertainties, Oct. 28, 2016
- Credit FAQ: Brexit Uncertainties Mean Higher Credit Risk And Lower Ratings For The U.K. Social Housing Sector, Oct. 31, 2016
- U.K.-Based Hyde Housing Association 'A+' Ratings Affirmed; Outlook Negative On Heightened Sales Risk, Oct. 31, 2016
- Notting Hill Housing Downgraded To 'A+' On Weakening Financial Profile; Outlook Negative On Heightened Sales Risk, Oct. 4, 2016

Ratings List

Rating

To

From

Guinness Partnership (The)

Issuer Credit Rating

Ratings List Continued...

| | | |
|----------------|----------------|--------------|
| Local Currency | A+/Negative/-- | A+/Stable/-- |
| Senior Secured | | |
| Local Currency | A+ | A+ |

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.

Copyright © 2016 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.