S&P Global
Ratings

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Incommunities Group Ltd.

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Incommunities Group Ltd.

*(**Editor's Note:** We corrected Table 1 in this full analysis on March 17, 2020, to reflect immaterial changes to FY2018 and FY2019 EBITDA and related metrics.)*

Key Rating Factors

Issuer Credit Rating
A+/Stable/--

Enterprise Profile	Financial Profile
Strong focus on low-risk activities balances the economic challenges of Incommunities Group Ltd.'s (Incommunities) region of operations, supporting a strong enterprise profile. • U.K.-based Incommunities maintains its strong focus on social and affordable rental homes, which provide stability to its revenue streams. However, we expect first tranche and outright sales to increase, causing exposure to market sales to reach a peak in 2022 at 14% of total revenues. • The Leeds region is a challenging area of operations, and this limits the group's flexibility when managing voids and arrears. • In our view, management has sufficient expertise in the housing sector, and has set transparent and conservative policies to conduct its business.	Declining debt in improved market conditions and a solid liquidity position underpin Incommunities' strong financial profile. • We expect Incommunities' EBITDA margin to remain moderate despite the end of the rent reduction regime attributed mainly to the group's stock rationalization program. • Incommunities' debt profile will benefit from improved conditions achieved after the refinancing program. • Robust financial policies support our estimation that the group will maintain its very strong liquidity position.

Outlook

The stable outlook reflects our view that Incommunities' financial management will maintain an adjusted EBITDA margin higher than 20% along the forecasted period, resulting in lower funding needs and a very strong liquidity position. The outlook also reflects our view that the group will maintain moderate exposure to market related activities, in line with its conservative development strategy.

Upside scenario

We could upgrade the rating on Incommunities if it improved its asset quality and operational performance by reducing void rates and gross arrears. We could also take this action if management were able to build a track record aligning with its corporate strategy.

Downside scenario

We could lower the rating if Incommunities deviated significantly from its current business strategy, which would likely pressure its financial performance and weaken its liquidity position. Renewed pressure on the U.K.'s sovereign credit ratings over the next two years could also put the rating under pressure. In addition, we could lower the rating on Incommunities if we believed that the likelihood of timely extraordinary support from the U.K. government were to decrease.

Rationale

We expect Incommunities to maintain its strong focus on low-income social housing activities that provide predictable revenue streams. While we forecast developments for market sales to ramp up by 2022, revenues from these activities will remain low, representing less than 15% of total revenues, and supporting our assessment of low industry risk for Incommunities. We view the social housing industry as low risk predominantly due to its anti-cyclical nature and strong oversight from the Regulator of Social Housing.

In our view, the group's flexibility is limited given the economic challenges of the area where it operates. Incommunities owns and manages roughly 22,000 units, concentrated in Bradford and Huddersfield, where lower population growth and lower market rents hamper demand. These factors have led to higher vacancy rates than peers' and high levels of gross arrears, which stood at 11% when measured against of rental income as of fiscal year (FY) 2019, the highest among our rated entities.

We believe Incommunities' management has sufficient expertise in the housing sector, and a set of comprehensive financial policies attuned to the risks identified on the nature of its core business. We also view positively the conservative business plan that the group has put in place.

We estimate Incommunities' adjusted EBITDA will remain modest, but stay above 20%, between FY2020-FY2022. Similar to other associations focused on the low-income housing, Incommunities' performance has taken a toll from the rent reduction regime and as such, EBITDA margins have decreased gradually over the last two years, and will remain lower in our estimation for FY2020. While we expect Incommunities will have flexibility to increase its rent from 2021, we believe EBITDA will not recover significantly, mainly due to the stock rationalization program that meaningfully reduces social units from 2021.

Over 2020-2021, we believe Incommunities will reduce its outstanding debt to below 13x our estimated EBITDA, supported by stable financial performance and a conservative business plan. Incommunities' successful completion of its refinancing program in March 2019 has improved the cost of debt and therefore strengthened our forecasted EBITDA interest coverage, which we estimate to remain above 2x in 2021-2022, from 1.5x in 2019.

We factor into the rating one notch of uplift above Incommunities' stand-alone credit profile, reflecting our view that there is a moderately high likelihood that the U.K. government, via the Regulator for Social Housing, would provide extraordinary support in the event of financial distress. This assessment is based on our view that Incommunities plays an important role in the government's public policy mandate to provide affordable housing across the country, and that there is a strong link between Incommunities and the U.K. government, via the Regulator of Social Housing.

Incommunities retains its very strong liquidity position, with a ratio of sources covering uses slightly below 3x. We also consider that the group has a satisfactory access to the capital markets and could obtain additional funding if needed.

Liquidity sources include:

- Cash of more than £9 million;
- Access to £60 million of undrawn committed facilities, falling due beyond 12 months;
- Our forecasted internally generated cash flow over the next 12 months totaling around £24 million;
- Proceeds from asset sales of about £1 million; and
- Capital grants of close to £0.6 million.

Liquidity uses include:

- Capital expenditure close to £7 million; and
- Debt service obligations of around £25 million.

Key Statistics

Table 1

Incommunities Group Ltd.--Key Statistics

	--Year ended March 31--				
(Mil. £)	**2018a**	**2019a**	**2020e**	**2021bc**	**2022bc**
Number of units owned or managed	21,897	22,088	22,182	21,999	22,061
Vacancy rates (% of rent net of identifiable service charge)	2.6	1.5	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)	9.8	10.7	N.A.	N.A.	N.A.
Revenue§	97.7	97.6	99.8	109.3	116.6
Share of revenue from nontraditional activities (%)	0.0	0.7	3.7	10.3	13.9

Table 1

Incommunities Group Ltd.--Key Statistics (cont.)					
	--Year ended March 31--				
(Mil. £)	**2018a**	**2019a**	**2020e**	**2021bc**	**2022bc**
EBITDA†	26.4	24.5	22.5	23.8	24.3
EBITDA/revenue (%)	27.1	25.1	22.5	21.7	20.9
Interest expense	15.0	15.0	11.8	11.4	11.0
Debt/EBITDA (x)	10.9	12.5	13.3	12.1	11.4
EBITDA/interest coverage* (x)	1.8	1.6	1.9	2.1	2.2
Capital expense†	16.2	23.4	11.3	6.0	6.3
Debt	289.0	305.9	299.5	286.7	278.6
Housing properties (according to balance sheet valuation)	429.5	437.9	N.A.	N.A.	N.A.
Loan to value of properties (%)	67.3	69.9	N.A.	N.A.	N.A.
Cash and liquid assets	16.0	11.5	9.7	5.0	5.0

§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

Incommunities Group Ltd.--Ratings Score Snapshot	
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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

Ratings Detail (As Of March 6, 2020)*	
Incommunities Group Ltd.	
Issuer Credit Rating	A+/Stable/--
Issuer Credit Ratings History	
19-Dec-2019	A+/Stable/--
07-Mar-2019	A+/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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