Research Update:

U.K. Social Housing Provider Home Group Ltd. 'A-' Ratings Affirmed; Outlook Stable

August 22, 2024

PRIMARY CREDIT ANALYST

Mahek Bhojani
London
+44 2071760846
mahek.bhojani
@spglobal.com

SECONDARY CONTACT

Colleen Sheridan
London
+44-20-7176-0561
colleen.sheridan
@spglobal.com

ADDITIONAL CONTACT

Sovereign and IPF EMEA
SOVIPF
@spglobal.com

Overview

- In our view, Home Group Ltd.'s strategic decision to reduce its market sales exposure on a structural basis will add resilience to its business model.
- We forecast a strong recovery of the group's financial indicators, supported by the projected steady increase in rental income, tight cost controls, and the management's ability to improve margins on its care and support business.
- We expect Home Group's debt accumulation to remain modest, which, combined with the projected improvement in our nonsales-adjusted EBITDA, will strengthen the interest coverage through fiscal year-end 2027 (March 31, 2027).
- We therefore affirmed our 'A-' long-term issuer credit rating on Home Group and maintaining the stable outlook.

Rating Action

On Aug. 22, 2024, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on Home Group Ltd. The outlook is stable.

At the same time, we affirmed our 'A-' issue rating on Home Group's £350 million senior secured bond.

Outlook

The stable outlook reflects our view that the group's strategy to de-risk its development program, along with its expanding rental asset base and flexibility in plans will help mitigate cost and investment pressures.

Downside scenario

We could lower the rating if Home Group's financial indicators weakened structurally. This could happen if a significant increase in its cost base had a more severe effect on the group's S&P Global Ratings-adjusted EBITDA than we project. Along with an increase in debt-funded capital spending, this could weaken the group's interest coverage to below 1x on a sustained basis.

Upside scenario

We could raise the rating if management's efforts to control costs or secure additional grants for investments in existing stock translate into its adjusted EBITDA improving above our current projections. This will also help strengthen the group's debt metrics, all else remaining equal.

Rationale

The affirmation reflects our view that Home Group's strategic decision to de-risk its development program, expected improvement in the economic conditions and the management's ability to secure grant funding for investments in new and existing homes would support the projected recovery in the group's financial indicators, following a dip in fiscal 2025.

We forecast the group's adjusted EBITDA will recover on the back of increasing rental income, tight cost control, and our projection that repair spending will return to more moderate levels following a spike in fiscal 2025. Furthermore, we forecast the higher levels of capital grant funding secured for investment in new homes will keep the group's debt build-up at a contained level, supporting the strengthening of its debt metrics to fiscal 2027. We estimate that liquidity remains solid.

Enterprise profile: Operational metrics will benefit from large portfolio size, strong demand and contained exposure to market sale activities

We view Home Group as a traditional social housing provider, with solid demand for its properties. It owns and manages a large portfolio of over 55,000 homes across the U.K., comprising social and affordable homes, shared ownership, sheltered and supported housing, and mid-market rented properties. We think that the group's social and affordable needs rents, which we estimate at just under 65% of the average market rent across the area of operations, point to affordability of its services, supporting demand. The group's vacancy rates average at about 2.9% over the past three years, which we assess to be higher than the sector average. We understand that this is mainly due to the group's supported housing portfolio for which voids are, in general, higher compared with affordable rented homes. We continue to believe that the demand for the group's supported housing tenure remains strong, given the rapidly aging population in the country.

We favorably assess the group's strategic shift to de-risk its development program because it reduces volatility in its revenue base. We forecast that revenue stemming from sale of first tranche shared ownership units and outright sales, including market sales coming from the group's joint ventures (JVs), will remain comfortably below one-third of the group's adjusted revenue through fiscal 2027. In our view, this reduction in the group's market sales exposure is structural and underpinned by the management's prudent decision to contain its sales risk appetite.

In our view, Home Group's strategy and targets align well with its operational capabilities. The group's development program remains quite flexible, with a large part of its capital expenditure being uncommitted, more than 50% on average over our forecast horizon through the end of fiscal 2027.

The management's sector expertise is demonstrated by its ability to improve performance on its inherently low-margin care and support business segment. Over the past year, the group successfully negotiated contract uplifts with commissioners to match cost increases, while also closing or redesigning some of its individual low-margin care and supported housing services. This, along with management's efforts to generate cost efficiencies, will provide the group with some headroom to address cost and investment pressures, in our view.

Financial profile: Increasing rental income, higher levels of secured capital grant funding, and solid liquidity will support Home Group's financial metrics

We forecast the group's adjusted EBITDA margins to gradually recover after a projected dip in fiscal 2025. The group's capitalized repairs spend is expected to spike in fiscal 2025 owing to higher sustainability investments and the cyclicality associated with its planned component replacement lifecycle. In our view, along with additional spends, mainly in relation to the expansion of its in-house repairs service model, this will put pressure on the group's adjusted EBITDA for the year. Starting fiscal 2026, we anticipate repair spending to return to more moderate levels, which, combined with the management's cost-saving measures and the group's increasing rental income, supports our expectation that margins will improve to about 16% by the end of our forecast horizon.

We forecast Home Group's interest coverage to strengthen to well above 1x by the end of our forecast horizon. This is supported by our projected recovery in the group's nonsales-adjusted EBITDA and improvement in the interest rate environment. Despite the increase in build costs, we expect the higher levels of capital grants secured will help contain the debt accumulation. We understand that one of Home Group's development contractors has very recently made a claim against the group. However, in our view, even if this claim were to materialize in the future, it alone will not have any major impact on the group's financials.

We assess Home Group's liquidity position as very strong. We estimate sources of liquidity will cover uses by about 1.9x in the next 12 months. This is based on our forecast of liquidity sources of about £525 million (mainly comprising cash and undrawn available facilities, grant receipts, inflows from JVs, proceeds from fixed-asset sales, and cash from operations after adding back the noncash cost of sales), compared with liquidity uses of about £283 million (primarily capital expenditure, interest, and principal repayments). We consider that Home Group has satisfactory access to external funding if needed.

Government-related entity analysis

We believe there is a moderately high likelihood that Home Group would receive timely extraordinary government support in case of financial distress. This provides one notch of uplift from the stand-alone credit profile. As one of the Regulator of Social Housing's (RSH's) key goals is to maintain lender confidence and low funding costs across the sector, we believe it is likely that the RSH would step in to try to prevent a default in the sector. We base this view on previous records of the RSH mediating mergers or arranging liquidity support from other registered providers in cases of financial distress, and we think this would also apply to Home Group.

Selected Indicators

Table 1

Home Group Ltd.--Key statistics

	--Year ended March 31--				
Mil. £	2023a	2024e	2025bc	2026bc	2027bc
Number of units owned or managed	56,200	56,840	56,891	57,073	57,436
Adjusted operating revenue	450.8	483.9	488.7	486.3	520.6
Adjusted EBITDA	49.8	65.3	55.6	74.7	83.2
Non-sales adjusted EBITDA	40.3	60.6	53.3	71.7	78.3
Capital expense	158.4	175.0	201.1	189.9	192.8
Debt	1,226.5	1,298.9	1,346.9	1,398.9	1,450.9
Interest expense	48.8	56.3	58.4	57.0	58.2
Adjusted EBITDA/Adjusted operating revenue (%)	11.0	13.5	11.4	15.4	16.0
Debt/Non-sales adjusted EBITDA (x)	30.4	21.4	25.3	19.5	18.5
Non-sales adjusted EBITDA/interest coverage(x)	0.8	1.1	0.9	1.3	1.3

a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

Home Group Ltd.--Ratings score snapshot

	Assessment
Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	3
Management and Governance	3
Financial risk profile	4
Financial performance	5
Debt profile	5
Liquidity	2
Stand-alone credit profile	bbb+
Issuer Credit Rating	A-

S&P Global Ratings bases its ratings on non-profit social housing providers on the seven main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on June 1, 2021, summarizes how the seven factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, June 1, 2021
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- United Kingdom, April 22, 2024
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2024, March 11, 2024
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2024, March 11, 2024
- Non-U.S. Social Housing Providers Ratings History: March 2024, March 11, 2024
- U.K. Social Housing Borrowing 2024: Borrowing Capacity Remains Constrained, March 6, 2024
- European Housing Markets: Forecast Brightens Amid Ongoing Correction, Jan. 25, 2024
- Non-U.S. Social Housing Sector Outlook 2024: At A Turning Point?, Nov. 29, 2023
- Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks, Oct. 23, 2023
- U.K. Social Housing Providers' Credit Headroom Could Tighten If The Operating Environment Deteriorates, Oct. 4, 2023
- U.K. Social Housing Providers Set Their Sights On Cyber Risks, Dec. 16, 2022

Ratings List

Ratings Affirmed	
Home Group Ltd.	
Issuer Credit Rating	A-/Stable/--
Home Group Ltd.	
Senior Secured	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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.