Research Update:

U.K. Social Housing Provider Home Group Ltd. Affirmed At 'A-'; Removed From Under Credit Observation; Outlook Stable

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Overview

- We expect Home Group Ltd.'s financial performance to weaken, mainly due to an increase in existing asset investments.
- Pressure on profitability, combined with increasing funding needs to meet development plans, will increase Home Group's debt burden. However, the group's favorable cost of debt and strong underlying social housing portfolio should help keep interest coverage at modest levels.
- The group maintains a solid liquidity position that would enable it to tackle unforeseen risks.
- We affirmed our 'A-' long-term issuer credit rating on Home Group and removed it from under criteria observation (UCO). The outlook remains stable.

Rating Action

On Aug. 20, 2021, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on Home Group. The outlook remains stable. We also removed the rating from UCO, where we placed it following the implementation of our updated criteria for social housing providers on June 1, 2021.

We also affirmed our 'A-' issue rating on Home Group's £350 million bond senior secured bonds.

Outlook

The stable outlook reflects our view that strong demand for Home Group's services will support gradual recovery of the group's profitability and contain the pressure on the group's leverage. It also reflects our expectation that the group's liquidity position will remain solid.

Downside scenario

We could lower the rating if Home Group's financial profile weakens structurally. This could materialize if the group increases its exposure to low-margin sale activities and investment in housing stock significantly beyond our base-case assumptions, leading to a material deterioration in profitability. This could also pressure the group's liquidity and lead to further debt accumulation.

Upside scenario

We could raise the rating on Home Group if it improves its profitability sooner than we expect in our base case. This could materialize if the group offsets the forecast increase in maintenance spend. Under such a scenario, we would expect either S&P Global Ratings-adjusted EBITDA margins to be structurally above 20% or a material improvement in debt metrics on a sustained basis.

Rationale

The rating reflects our view that Home Group's profitability will gradually improve, with adjusted EBITDA reaching close to 20% of revenue by the end of our base-case period. We expect the expanding asset base to slowly alleviate the pressure on the group's financial performance stemming from the rise in existing asset investments to meet regulatory requirements and environmental targets. Despite the growing funding needs, we expect the group will maintain modest non-sales interest cover and a solid liquidity position.

We think there is a moderately high likelihood that Home Group would receive timely extraordinary government-related support in the event of financial distress. This provides one notch of uplift from the stand-alone credit profile. One of the Regulator for Social Housing's (RSH) key goals is to maintain lender confidence and low funding costs across the sector. We therefore think it is likely that the RSH would step in to try and 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.

We assess the regulatory framework under which registered providers of social housing in England operate as strong, underpinned by their public policy mandate to provide affordable homes. We also consider that the sector benefits from solid ongoing oversight by the RSH. Offsetting these strengths, we consider that providers in England receive relatively low levels of grant funding for the development of affordable homes. We note that providers in England can develop homes for outright sale, using the proceeds as an alternative funding source; however, we think this exposes them to risks and potential volatility compared with providers in other regions. Providers in England are also subjected to negative intervention from the U.K. government in the form of rent-setting constraints or additional spending responsibilities, without adequate additional funding. This weighs on our view of the regulatory framework assessment.

Home Group owns and manages a large portfolio of almost 55,000 homes comprising social and affordable homes, shared ownership, sheltered and supported housing, and market-rented properties across the U.K.

The majority of Home Group's footprint is in the North of England, and we estimate its average social rent equals 67% of the average market rent. Although this ratio is slightly more favorable than similarly located peers', it is higher than London-based peers'.

Furthermore, we assess the group's average vacancy rate at close to 3%, which is almost double the sector average, indicating a relatively higher re-let time. These high levels of vacancy rates stem from the group's large portfolio of supported housing, for which void levels tend to be higher compared to affordable homes.

Although we forecast Home Group will generate the majority of its revenue from traditional rental activities, a significant portion will continue to stem from sales receipts, which we expect to peak at slightly above one third of total revenue--including joint ventures (JVs)--in the financial year ending March 31, 2023 (FY2023). We think this exposes the group's financials to relatively higher risk from real estate market volatility compared to peers with a greater focus on traditional social housing activities.

We consider that management continues to demonstrate the skills and expertise required to manage Home Group's diversity and scale of operations. We expect the group will continue with its plan to complete close to 10,000 homes over the next five years (FY2022-FY2026); Home Group would deliver about 7,200 of these, with JVs and other partnerships delivering the remainder. However, taking into consideration market uncertainties and the sector's focus on the evolving green agenda and efficiency targets, we note that management has incorporated more flexibility toward achieving these development targets by focusing its strategy on "right homes in the right place". This is also reflected in more than 50% of the group's development plan being uncommitted. We view positively this strategic planning and risk management. We also expect management to expand its support and care segment by providing services directly to the U.K. National Health Service. We understand the initial cost for this integration of housing and health provision would be high; however, once the model is set up, this scheme would be quite profitable for the group, as well as very beneficial to the community.

We forecast that an increase in existing asset investments, combined with the potential loss of income due to the pandemic in FY2022, will delay improvement in Home Group's financial performance. Following lockdown-induced delays in the group's repair program for FY2021, we expect it to catch up on the maintenance spend and make additional investments toward achieving efficiency and environmental targets from FY2022. We think the combination of increased costs and sustained low margins on supported care and market sale activities will keep adjusted EBITDA margins below 20% of revenue on average over our forecast horizon.

We expect a gradual increase in debt levels to fund the group's capital program, which, combined with the pressure on the profitability, will result in moderate debt metrics. We expect the group's development plan to peak over FY2023 and FY2024 because a significant amount of the Homes England Strategic Partnership delivery will come through in these years. However, we understand the group is also planning some tactical and strategic disposals and that the proceeds from these fixed assets sales will help alleviate some pressure on the debt levels.

We expect debt-to-non-sales adjusted EBITDA to average at about 16.7x over our five-year base-case period, with non-sales-adjusted EBITDA interest cover averaging about 1.5x over the same period.

Liquidity

We consider Home Group's liquidity position as strong. The group has large undrawn facilities and moderate cash levels. In our base case, liquidity sources of about £647 million will cover uses of £366 million by about 1.8x over the next 12 months. We continue to view Home Group's access to external liquidity as satisfactory.

Liquidity sources include:

- Cash flow from operations of about £160 million;

- Cash balances of £24 million;
- Undrawn committed bank lines of about £380 million;
- Asset sales of close to £45 million; and
- Grant income and other cash inflows totaling about £38 million.

Liquidity uses include:

- Capital expenditure and development spend of close to £300 million; and
- Interest and principal repayments of about £68 million.

Key Statistics

Table 1

Home Group Ltd. -- Key Statistics

	--Year ended March. 31--				
(Mil. £)	2020a	2021e	2022bc	2023bc	2024bc
Number of units owned or managed	55,060	55,392	56,097	56,930	57,687
Adjusted operating revenue	397.74	420.86	407.42	498.41	513.43
Adjusted EBITDA	88.78	96.79	66.72	87.06	100.17
Non-sales adjusted EBITDA	80.47	88.57	60.16	73.95	84.32
Capital expense	149.15	92.61	269.03	360.55	283.10
Debt	1,181.16	1,150.90	1,248.19	1,359.50	1,391.31
Interest expense	48.64	47.89	48.63	51.76	53.91
Adjusted EBITDA/adjusted operating revenue (%)	22.32	23.00	16.38	17.47	19.51
Debt/non-sales adjusted EBITDA (x)	14.68	12.99	20.75	18.38	16.50
Non-sales adjusted EBITDA/interest coverage(x)	1.65	1.85	1.24	1.43	1.56

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

Home Group Ltd. -- Ratings Score Snapshot

	Assessment
Enterprise risk profile	3
Industry risk	3
Regulatory framework	3
Market dependencies	4
Management and Governance	3
Financial risk profile	4
Financial performance	5

Table 2

Home Group Ltd. -- Ratings Score Snapshot (cont.)

	Assessment
Debt profile	4
Liquidity	2

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

- 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
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- Ratings On Nine Social Housing Providers Placed Under Criteria Observation On Criteria Update, June 1, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 23, 2021
- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021
- 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

Ratings List

Ratings Affirmed	
Home Group Ltd.	
Issuer Credit Rating	A-/Stable/--
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