Research Update:

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

August 18, 2023

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Overview

- We expect U.K.-based housing provider Home Group Ltd. will scale back its development of new homes while increasing investments in its existing stock.
- We project the flexibility in the group's plans and growing rental income will somewhat mitigate the cost pressures on the group's financial performance.
- In combination with a lower debt build-up, we expect the group's debt profile will gradually strengthen through the forecast period to March 31, 2026, though the recovery will be slower than previously projected.
- We therefore affirmed our 'A-' long-term issuer credit rating on Home Group. The outlook is stable.

Rating Action

On Aug. 18, 2023, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on Home Group. 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 expanding asset base and the flexibility in Home Group's plans will somewhat offset the current headwinds in the sector and the group's need to invest in existing and new homes.

Downside scenario

We could lower the ratings 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 expected. Along with an increase in debt-funded capital spending and rising interest rates, this could weaken the group's debt metrics on a sustained basis.

Upside scenario

We could raise the ratings if we saw a strategic reduction in the group's sales risk appetite and if the management prudently executed its plans such that adjusted EBITDA structurally improved beyond our current projections. This would make the group's business model more resilient and strengthen Home Group's financial indicators on a sustained basis.

Rationale

The affirmation reflects our view that a gradual recovery in EBITDA and contained debt build-up will help Home Group to partly absorb the current sector pressures associated with inflation, tightened funding conditions, and increasing investments in existing homes.

Enterprise profile: Operational metrics benefit from the large portfolio and flexible plans

Home Group 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 market-rented properties. Almost 55% of the group's properties are located in north England. We think that the group's social and affordable needs rents, which we estimate are just under 65% of the average market rent across the area of operations, reflect strong affordability levels that support the demand for Home Group's properties. The group's vacancy rate was, on average, about 2.9% over the past three years. We assess this is higher than the sector average, mainly due to the group's supported housing portfolio. The vacancy rate of the group's general needs properties, however, is similar to the sector average. In the case of supported housing, we note that void periods between tenancies are, in general, longer, compared with affordable rented homes. In our view, the strong demographic tailwinds in England, with its rapidly aging population, will support the demand for supported housing.

We consider that management continues to demonstrate the skills and expertise required to manage Home Group's diverse portfolio and large scale of operations. The group continues to expand its support and care segment by providing services to a range of commissioners, including the U.K. National Health Service and local authorities. We understand that the initial costs for the integration of housing and health provision would be high. In the long run, however, this initiative will be beneficial to the group and the community it will serve if it is delivered in the right manner. Nevertheless, we believe there are financial risks associated with this inherently low-margin business segment.

We believe Home Group's investments in new and existing homes provide some level of flexibility. We understand that the group aims to generate cost efficiencies, which--along with some discretionary spends included in its existing asset investments--will provide Home Group with added flexibility to reprofile costs if needed.

We understand that a material part of the group's development program remains uncommitted. This has enabled the group to significantly scale back and de-risk its capital program relatively quickly in response to rising funding costs, increasing investments in existing stock, and the U.K.

government's rent cap for the social housing sector in England. Over our forecast horizon (financial year ending March 31, 2024, to financial year 2026), we expect the group will develop close to 2,400 new homes on its balance sheet that will not include joint ventures and flexi-rent homes. This is about 40% less than we previously estimated.

In our view, Home Group continues to have material exposure to market sales risk. Though revenue stemming from the sale of the first tranche of shared ownership units and outright sales--including markets sales coming from the group's joint ventures--has reduced to, on average, about 25% of the group's adjusted revenue, we believe that the de-risking of the capital program is motivated by current market challenges rather than a longer-term strategic shift in the group's sales risk appetite.

Financial profile: Increasing rental income, contained debt levels, and solid liquidity will support Home Group's financial metrics

We expect the narrowing gap between cost and rent increases and the group's expanding asset base will support a gradual recovery in adjusted EBITDA, from a weakened position in financial year 2023. We understand that the group incurred some nonrecurring costs of slightly above £10 million, the majority of which was in relation to an early exit of one of Home Group's repairs and maintenance contractors in financial year 2023. This, combined with the inflationary pressures and increasing investments in existing stock, resulted in significantly weaker margins for the year. We think that the relatively low margins, associated with the group's supported care activities, will continue to weigh on its financial performance.

We project that Home Group's adjusted debt metrics will gradually strengthen from weak levels in financial year 2023. Due to the reduced delivery of homes, debt intake is lower than in our previous base case. This, along with the expected recovery in non-sales EBITDA, will keep the group's interest coverage above 1x over our forecast horizon.

We forecast Home Group's liquidity position will be very strong. We estimate sources of liquidity will cover uses by 1.7x in the next 12 months. This is based on our forecast of liquidity sources of about £468 million (mainly comprising cash and undrawn available facilities, grant receipts, proceeds from fixed asset sales, and cash from operations after adding back the noncash cost of sales), compared with liquidity uses of about £282 million (primarily capital expenditure, interest, and principal repayments). We anticipate a slight weakening in the liquidity coverage ratio. Yet, the decline should be temporary because we understand that the group has signed an extended facility agreement, which is expected to be fully secured in the next few weeks. We also 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. £)	2022a	2023e	2024bc	2025bc	2026bc
Number of units owned or managed	55,674	56,200	56,776	56,881	56,971
Adjusted operating revenue	411.1	448.7	447.1	472.0	486.5
Adjusted EBITDA	80.0	47.6	63.3	71.9	78.1
Non-sales adjusted EBITDA	72.4	38.2	59.8	68.3	74.3
Capital expense	142.7	158.4	225.5	170.0	160.5
Debt	1,181.4	1,226.5	1,323.2	1,346.8	1,366.8
Interest expense	43.1	48.8	55.1	56.4	54.3
Adjusted EBITDA/Adjusted operating revenue (%)	19.5	10.6	14.2	15.2	16.1
Debt/Non-sales adjusted EBITDA (x)	16.3	32.1	22.1	19.7	18.4
Non-sales adjusted EBITDA/interest coverage(x)	1.7	0.8	1.1	1.2	1.4

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

Enterprise risk profile	3
Industry risk	3
Regulatory framework	3
Market dependencies	3
Management and governance	3
Financial risk profile	4
Financial performance	5
Debt profile	5
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

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

Related Research

- United Kingdom Outlook Revised To Stable From Negative On Moderating Fiscal Risks; 'AA/A-1+' Ratings Affirmed, April 21, 2023
- U.K. Social Housing Borrowing 2023: On Pause, March 28, 2023
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings History: March 2023, March 27, 2023
- U.K. Social Housing Providers Set Their Sights On Cyber Risks, Dec. 16, 2022
- Non-U.S. Social Housing Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022
- Inflation To Erode The Performance Of U.K. Public Finance Sectors, Nov. 29, 2022
- Cap On Rent Increases Is Consistent With Our Base Case For English Social Housing Providers, Nov. 17, 2022
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 2022
- Launch Of Rent Cap Consultation Adds Uncertainty To Creditworthiness Across English Housing Sector, Sept. 1, 2022
- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

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.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website 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; or Stockholm (46) 8-440-5914

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