Research Update:

Home Group 'A-' Rating Affirmed On Reduced Development Plan; Outlook Stable

December 18, 2020

Overview

- U.K.-based Home Group Ltd.'s new five-year strategic plan involves reducing sales exposure and investing more in existing stock.
- We expect the solid performance of the underlying social housing portfolio will continue to support Home Group's S&P Global Ratings-adjusted EBITDA margins and interest coverage.
- We are therefore affirming our 'A-' long-term issuer credit rating on Home Group.
- The stable outlook indicates that we expect Home Group to focus on strengthening financial performance, while retaining its strong liquidity and low leverage.

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Rating Action

On Dec. 18, 2020, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on U.K.-based social housing provider Home Group Ltd. The outlook is stable.

We also affirmed our 'A-' issue rating on the £350 million senior secured bonds, issued directly by Home Group.

Rationale

One or more of the credit ratings referenced within this article was assigned by deviating from S&P Global Ratings' published criteria. We think that significant exposure to sales activities limits visibility and predictability of future earnings in a way not typically seen with a traditional housing association providing mainly social rent properties. In our view, exposure to sales activities will also reduce the ability to withstand external risks. We therefore deviate from our "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, when assessing the industry risk for housing associations that generate more than one third of their revenues from market sales. We do this by blending S&P Global Ratings' industry risk assessment for social housing providers (2), and that for homebuilders and real estate developers (4) in line with the "Key Credit Factors For The Homebuilder And Real Estate Developer Industry" criteria published on Feb. 3, 2014. For more information see "Credit FAQ: How S&P Global Ratings Assesses Industry Risk For English Social Housing Providers," published on Aug. 6, 2018.

The affirmation reflects that Home Group's underlying social housing business will continue mitigating risks from increased expenditure on the development program and housing stock. This will result in stabilizing adjusted EBITDA margins and debt metrics through the financial year ending March 31, 2023 (FY2023).

As with other English housing associations, we believe there is a moderately high likelihood that Home Group would receive extraordinary support in case of financial distress. This provides a one-notch uplift from the stand-alone credit profile. Home Group's primary purpose is to provide affordable homes, supporting important policy objectives of the U.K. government. We consider that the Regulator of Social Housing (RSH), a government agency, regulates Home Group to promote a viable, efficient, and well-governed social housing sector, and maintain lender confidence and low funding costs across the sector. It is therefore our view that the RSH would step in to prevent a default in the sector, based on its record of being willing and able to provide extraordinary support on a timely basis.

In response to weaker-than-expected FY2020 results and the impact of the COVID-19 pandemic, Home Group's five-year business plan through to FY2025 considerably reduced its development pipeline by 27% to just over 9,000 units, and can reduce it further as 57% of the plan remains uncommitted. Partially offsetting this reduction, capitalized repairs are expected to rise significantly in FY2022 to £35 million from £22 million in FY2020 and we project S&P Global Ratings-adjusted EBITDA margins to remain constrained at around 22%, which is below the 26% we had previously forecast.

Home Group delivered 1,179 new homes at the end of FY2020 and has been diligently working on selling unsold units, which stood at 381 as of March 30, 2020. To achieve these sales, Home Group established a virtual viewing platform that assisted in lead generation throughout lockdown and helped to bring the number of unsold units down to 275, with 100 reserved by November 2020.

Home Group owns and manages a large and geographically diverse portfolio of social and affordable homes, comprising the majority or about 82% of the properties, sheltered and supported housing and mid-market rented properties totaling over 55,000 homes across the U.K. With Home Group's exposure to Northern England and Scotland, the 2020 weighted-average growth calculation falls to around 0.4%. This growth, combined with our assessment that Home Group's social rent around 60% of the prevailing market rent, supports our view that demand for Home Group's homes will remain solid. On the back of the rollout of Universal Credit, we note that arrears continue to increase; gross arrears rose over 9% in June, but we understand that Home Group's investment in new software helped them nearly recover to pre-pandemic levels.

We consider Home Group's debt profile to be strong and one of the lowest in our rated portfolio. We understand that the group plans to fund the majority of its current business plan by receipts from shared ownership and outright sales, slightly offsetting external funding needs, which we estimate at £85 million in FY2022. Nevertheless, given the scope of the development program, we forecast Home Group's borrowing needs to increase under our base-case scenario, resulting in its debt-to-EBITDA margin averaging 13x over FY2020-FY2022, which is lower than the U.K. median of 16.3x. The debt profile is further supported by strong interest coverage at around 1.9x over our forecast period. We note that interest coverage from non-sales earnings remains solid at around 1.6x.

Liquidity

We consider Home Group's liquidity position as strong, mainly thanks to ample undrawn liquidity facilities and moderate cash levels. In our base case, liquidity sources of around £641 million will cover uses of £376 million by about 1.71x over the next 12 months, which is above our last review and follows the industry trend of raising more liquidity during uncertain times.

Liquidity sources include:

- Cash and short-term investments of around £15 million;
- Operating cash flow (including working capital adjustments) of more than £125 million;
- Undrawn short-term bank lines of about £350 million;
- Receipts from asset sales of some £38 million; and
- Government grants of more than £23 million.

Liquidity uses include:

- Expected capital expenditure related to fixed assets of around £301 million; and
- Interest and principal payments due over the next 12 months of some £75 million.

We view Home Group's access to external liquidity as satisfactory, given its ready access to bank funding, but we consider its track record of issuance in the capital markets to be limited. Home Group accessed the market in May 2020, selling £100 million of its retained bond that yielded 2.31%.

Outlook

The stable outlook reflects our view that Home Group's underlying social housing business will continue mitigating risks from increased expenditure on the development program and housing stock. This will result in stabilizing adjusted EBITDA margins and debt metrics through FY2023.

Downside Scenario

We could lower the rating in the next two years if Home Group's profitability metrics fell below 20%. This could happen if it further accentuated its development for sales or investment in housing stock.

Upside Scenario

We could raise the rating in the next two years if Home Group outperformed our base-case projection, and we observed material improvement in financial performance with margins structurally above 30% of revenues combined with very strong liquidity levels.

Key Statistics

Table 1

Home Group Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	2019a	2020a	2021bc	2022bc	2023bc
Number of units owned or managed	55,424	55,060	55,848	56,805	57,934
Revenue§	359.1	397.7	442.0	480.3	489.6
Share of revenue from sales activities** (%)	20.6	28.4	36.5	35.7	31.0
EBITDA§†	100.2	88.8	91.0	94.6	100.5
EBITDA/revenue §†(%)	27.9	22.3	20.6	19.7	20.5
Capital expense†	235.9	149.2	207.0	332.5	243.5
Debt	1,218.3	1,181.2	1,176.9	1,259.1	1,290.3
Debt/EBITDA §†(x)	12.2	13.3	12.9	13.3	12.8
Interest expense*	48.0	48.6	47.9	49.1	50.6
EBITDA/interest coverage§†* (x)	2.1	1.8	1.9	1.9	2.0
Cash and liquid assets	83.6	34.6	42.5	45.0	41.2

§Adjusted for grant amortization. †Adjusted for capitalized repairs. **Including shared ownership sales as well as outright sales *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

Home Group Ltd. Ratings Score Snapshot

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Financial policies	2
Financial profile	4

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: 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
- Criteria | Corporates | Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 3, 2014
- 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 Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020
- Outlook 2021: Strong Liquidity Should Help Social Housing Providers Remain Resilient, Dec. 8, 2020
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 23, 2020
- Economic Research: COVID-19 Deals A Larger, Longer Hit To Global GDP, April 16, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020
- COVID-19: The United Kingdom Deploys Its Fiscal And Monetary Arsenal, April 1, 2020
- U.K. Social Housing Ratings History: February 2020, March 3, 2020
- Why Most Rated U.K. Social Housing Providers Are At Home In The 'A' Category, Dec. 3, 2019

Ratings List

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