Home Group Ltd.

August 19, 2022

PRIMARY CONTACT

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

SECONDARY CONTACT

Karin Erlander
London
44-20-7176-3584
karin.erlander
@spglobal.com

This report does not constitute a rating action.

Credit Highlights

Overview

Enterprise profile	Financial profile
The resilience stemming from Home Group Ltd.'s large portfolio size and robust strategic planning will help offset some of the risks associated with its relatively high exposure to market sales activities.	Prudent cost management and expanding asset base, along with a contained debt build-up, will to some extent help Home Group absorb the pressures from rising inflation and the group's increasing investment in existing stock.
--The group benefits from operating in a predictable and countercyclical social housing sector, although its significant reliance on sale activities exposes it to risks associated with real estate market volatility.	--The potential cost efficiencies along with increase in rental income will help to gradually alleviate the cost pressures on the group's financial performance.
--The group's vacancy rates remain relatively high, stemming from its large exposure to supported housing, which continues to constrain our assessment of its market dependencies.	--The gradual recovery in S&P Global Ratings nonsales adjusted EBITDA in combination with reduced funding needs will support the group's relatively solid interest coverage.
--The strategy and planning process remains robust and consistent with the organization's operational capabilities.	--Liquidity coverage remains solid and is expected to strengthen further.

Outlook

The stable outlook reflects our view that the strong demand for Home Group's services and prudent planning will somewhat offset the risks associated with inflationary pressures and the group's increasing investments in existing and new assets.

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 costs rise significantly beyond our base-case assumptions, leading to a significant deterioration in financial performance. This could also weigh on the group's liquidity and lead to further debt accumulation.

Upside scenario

We could raise the rating on Home Group if it materially improves its financial metrics faster than we expect. This could happen if the group actively manages the current cost pressures. Under such a scenario, we would expect either S&P Global Ratings-adjusted EBITDA margins to be structurally above 20%, or a significant improvement in debt metrics on a sustained basis.

Rationale

Home Group owns and manages a large portfolio of over 55,000 homes comprising social and affordable homes, shared ownership, sheltered and supported housing, and market-rented properties across the U.K., with most of its footprint in the north of England. We think that the group's social and affordable needs rents, which we estimate to be just under 65% of the average market rent across the area of operations, reflect strong affordability levels that support the high demand for Home Group's properties. The group's vacancy rates stand at about 2.9% on average over the past three years, which we assess to be almost double that of the sector average. We understand that 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 with affordable rented homes.

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 directly to the U.K. National Health Service. We understand that the initial cost for this integration of housing and health provision would be high; however, after the initial mobilization period of each contract, the scheme will generate favorable margins for the group, as well as being of significant social benefit to the community.

The group's strategy continues to place emphasis on achieving sustainability targets such as energy efficiency and carbon neutrality. This is evidenced in about 72% of its stock already meeting Energy Performance Certificate (EPC) C standards (or higher).

Taking into consideration the current market uncertainties and sector challenges, the group plans on revising its development plan and reducing the number of home deliveries by about 650 units over the next three years. With this, we expect the group to develop close to 4,200 new homes on its balance sheet over our forecast horizon (financial year ending March 31, 2023 to financial 2025), which is about 8% of its current stock. We view positively the strategic planning to scale down the development program, which, along with more than 50% of this program being uncommitted, will provide the group with additional flexibility to react to market conditions and pull back on capital expenditure (capex), if required.

Although we expect Home Group to generate most of its revenue from traditional rental activities, a relatively high 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 financial 2024. We think this exposes the group to relatively higher risk from market volatility.

We anticipate that Home Group's growing asset base and increasing rental income will gradually offset cost and investment pressures, with margins improving to close to 20% by the end of our forecast horizon, financial 2025. We project that the stress on margins in financial 2023 will be temporary, driven largely by cost inflation materially exceeding the increase in rents. Looking ahead, we expect the gap between cost and rent increases to narrow, which, in combination with the potential cost savings, will support a gradual recovery in the group's financial performance. We think that the relatively low margins associated with the group's supported care and market sale activities will continue to weigh on EBITDA.

Home Group continues to fund its development program through a mix of new debt intake, grant funding, and proceeds from the strategic disposals of fixed assets. We forecast Home Group's debt intake to be lower in comparison with our previous base case, mainly owing to the reduced delivery of homes and subsequent lower capex. We project that the lower funding needs in combination with the gradual recovery in margins will support the improvement in the group's debt-to-nonsales-adjusted-EBITDA ratio and interest coverage over our forecast horizon.

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.

We assess the regulatory framework under which registered providers of social housing in England operate as strong (for more information see "Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers," published June 8, 2021).

Liquidity

We assess Home Group's liquidity position as very strong, with sources covering uses by 1.76x in the next 12 months. We understand that the group is in the process of securing some additional credit facilities, which in our view would further bolster its liquidity coverage. We continue to view Home Group's access to external liquidity as satisfactory.

Liquidity sources include:

- Cash and cash equivalents of about £26 million;
- Our forecast of cash flow from operations of about £184 million, adding back the noncash cost of sales;
- Proceeds from fixed asset sales of under £38 million;
- Available facilities maturing beyond the next 12 months of about £348 million; and
- Grant funding and other inflows of about £34 million.

Liquidity uses include:

- Capex of about £288 million, including spend on units for sale; and
- Interest and principal repayments of about £69 million.

Environmental, Social, And Governance

Home Group's performance on environmental, social, and governance (ESG) indicators is broadly in line with its sector peers. We think that social housing providers face social risks stemming from higher inflation and slower economic growth. However, the focus on core business of affordable social housing, which provides predictable and relatively stable earnings, should help mitigate some of these risks, as is the case for Home Group.

We think that environmental factors due to enhanced building and fire safety standards and a government agenda to improve energy efficiency in the sector could weaken social housing providers' profitability and put further pressure on the debt service capacity. In the near to medium term, this focus on increasing investments in existing homes could weigh on Home Group's performance. We assess the group's current asset quality to be on a par with its peers.

Key Statistics

Home Group Ltd. -- Key Statistics

	--Year ending March. 31--

Mil. £	2021a	2022e	2023bc	2024bc	2025bc
Number of units owned or managed	55,392	55,674	56,231	57,028	58,177
Adjusted operating revenue	420.9	411.1	443.9	535.6	539.2
Adjusted EBITDA	96.8	80.0	71.9	90.7	105.3
Non-sales adjusted EBITDA	88.6	72.4	65.5	79.1	93.3
Capital expense	92.6	131.3	273.5	317.5	307.1
Debt	1,150.9	1,147.5	1,241.1	1,301.9	1,376.8
Interest expense	47.9	48.3	49.4	52.4	55.0
Adjusted EBITDA/Adjusted operating revenue (%)	23.0	19.5	16.2	16.9	19.5
Debt/Nonsales adjusted EBITDA (x)	13.0	15.8	19.0	16.4	14.8
Nonsales adjusted EBITDA/interest coverage(x)	1.8	1.5	1.3	1.5	1.7

a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Rating Component Scores

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
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

- 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

- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022
- Regulatory Framework And Systemic Support Assessments For Nonprofit Social Housing Providers, Aug. 15, 2022
- Non-U.S. Social Housing Providers Ratings Risk Indicators, July 27, 2022
- Non-U.S. Social Housing Providers Ratings Score Snapshot, July 27, 2022
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 22, 2022
- U.K. Social Housing Sector Borrowing Needs To Rise To Fund Investment In New Homes, March 31, 2022
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings Detail (as of August 19, 2022)*

Home Group Ltd.	
Issuer Credit Rating	A-/Stable/--
Senior Secured	A-
Issuer Credit Ratings History	
14-Dec-2018	A-/Stable/--
08-Dec-2017	A/Negative/--
04-Jul-2016	A/Stable/--

*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.