S&P Global Ratings

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Research Update:

U.K.-Based Housing 21 Downgraded To 'A-'; Off UCO; Outlook Stable

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Overview

- We have completed our review of U.K. social housing provider Housing 21 (H21) following the publication of our "Methodology For Rating Public And Nonprofit Social Housing Providers" on June 1, 2021.
- Following our review, we lowered our long-term issuer credit rating on Housing 21 (H21) to 'A-' from 'A' and removed it from under criteria observation (UCO). The outlook is stable.
- The downgrade reflects the application of our new criteria and our reappraisal of H21's management and governance.
- We forecast that H21's profitability will be weaker than previously anticipated, due to the group's decision to convert all its affordable rental units to social rent.

Rating Action

On July 23, 2021, S&P Global Ratings lowered its long-term issuer credit rating on Housing 21 to 'A-' from 'A'. The outlook is stable. At the same time, we removed the rating from UCO.

We also lowered our issue rating on H21's £370 million senior secured bond to 'A-' from 'A'.

Outlook

The stable outlook reflects our view that strong demand for H21's services will support gradual recovery of the group's profitability and contain further weakening of its debt metrics. It also reflects our expectation that the group's liquidity position will remain solid.

Downside scenario

We could lower the ratings if we saw a substantial weakening in H21's liquidity position, with financial performance not recovering and in line with our forecasts. This could occur if the group increased its spend on development or on existing properties above our expectations, which could put additional pressure on H21's debt metrics, with interest cover falling to below 1x on a sustained basis. We could also lower the rating if we changed our view of the likelihood of extraordinary support from the U.K. government.

Upside scenario

Conversely, we could raise the rating on H21 if proactive management actions resulted in the group achieving a recovery in profitability earlier than we currently expect. Under such a scenario, we would expect either S&P Global Ratings-adjusted EBITDA margins to be above 20% or a material improvement in debt metrics on a sustained basis.

Rationale

The lowering of the rating on H21 reflects the application of our updated criteria, as well as our reappraised view of management, which now carries more weight in our analysis. Our assessment also reflects our view of some weaknesses in H21's planning and processes. We expect H21 will continue benefitting from solid demand for its services and remain focused on providing retirement and extra care housing, as well as care services. Nonetheless, as a result of the group's decision to convert all its affordable rental units into social rental units, we expect the group's profitability will be weaker than we previously anticipated. This will keep H21's leverage high.

We think there is a moderately high likelihood that H21 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 H21.

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. We think these strengths are offset by the relatively low levels of grant funding that the providers in England receive for the development of affordable homes. We consider that the 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 constraints of rent setting or additional spending responsibilities, without adequate additional funding. This weighs on our view of the regulatory framework assessment.

H21's focus on tenants aged 65 years old and above results in strong and increasing demand for its services. Supporting this are England's rapidly aging population and our estimate of the group's social to market rents being just below 70%. In the financial year ending March 31, 2021 (FY2021), the group saw increasing void losses compared with historical levels, reaching 2.8% of total rent receivables from 1.7% in FY2020. We think this is due to H21's type of service and more elderly customer base, which resulted in increased relet times during the pandemic. We think H21's size and large geographical footprint will support a gradual recovery in vacancy rates post-pandemic, which we think will return to below 2% in the medium term.

H21's strategy continues to largely focus on its retirement housing and extra care housing, as well as providing care services, where it is a national leading provider. The group's focus on its core business supports our view of predictable revenue streams and low industry risk. We forecast that the group will continue to develop units for sale over the forecast period. Most of these units will be designated for shared ownership first-tranche sales, with a small number designated for outright sales. We nonetheless expect H21's exposure to these activities to remain limited, at about 10% of turnover on average over the next three years. We note positively that 89% of H21's units have an energy performance certificate of C or above, and we think the group is well positioned to achieve the environmental targets that the sector needs to meet.

Since our last review, management has decided to convert all its affordable rental units into social rental units. This is a response to issues that the RSH identified in June 2020, which resulted in the regulator lowering H21's governance assessment to G2. Specifically, H21 did not reduce its affordable rental units' service charge by 1%, as was required in the Welfare Reform and Work Act 2016, and rents for slightly less than 200 of the group's extra care units were above the rent cap.

We understand H21 has already provisioned for refunds to affected tenants and we forecast that the rebase to social rent this year will have a medium-term knock-on effect on the group's profitability. We now expect adjusted EBITDA margins to average a low 14% over the next three years, compared with our previous forecast of a gradual recovery toward 20%. This also reflects our expectation that H21 will increase spend on existing properties compared with FY2021.

We forecast debt metrics will be under pressure because of the group's lower EBITDA from non-sales activities, despite only modest debt intake. We note that the group has scaled down its development targets for the coming three years. H21 has experienced some delays in program delivery and it has an increased cash position related to its bond tap in August 2020, so we think the group has sufficient funds to fund its development spend in the coming two years without issuing new debt. Nevertheless, leverage will remain high over the next three years, and debt to non-sales-adjusted EBITDA will exceed 20x on average over FY2022-FY2024, with non-sales-adjusted EBITDA interest cover averaging just above 1x over the same period.

Liquidity

We consider that H21's liquidity position has improved compared to our last review, largely due to the abovementioned higher cash position. We now project sources of liquidity to cover uses by about 2.2x.

Sources of liquidity include:

- Cash and liquid investments of just over £210 million;
- Forecast cash flow generated from operations of £58 million;
- Undrawn committed bank facilities of £25 million; and
- Grants and other inflows of about £38 million.

Uses of liquidity include:

- Adjusted capex of about £90 million;
- Interest and principal payable of about £47 million; and
- Other outflows of £10 million.

We continue to view H21's access to external liquidity as satisfactory.

Key Statistics

Table 1

Housing 21--Key Statistics

	--Year ended March 31				
(Mil. £)	2020a	2021e	2022bc	2023bc	2024bc
Number of units owned or managed	21,072	21,464	22,253	22,971	23,683
Adjusted operating revenue	190.2	194.7	224.1	232.3	230.5
Adjusted EBITDA	25.1	37.8	29.0	32.3	37.0
Non-sales adjusted EBITDA	24.9	35.6	23.5	28.3	35.0
Capital expense	79.1	84.6	77.4	131.2	154.4
Debt	570.2	672.5	653.7	633.9	670.7
Interest expense	26.0	27.3	28.3	27.2	27.1
Adjusted EBITDA/adjusted operating revenue (%)	13.2	19.4	12.9	13.9	16.0
Debt/non-sales adjusted EBITDA (x)	22.9	18.9	27.9	22.4	19.2
Non-sales adjusted EBITDA/interest coverage(x)	1.0	1.4	1.0	1.2	1.4

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

Housing 21--Ratings Score Snapshot

	Assessment
Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	2
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

- 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
- 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
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020

Ratings List

Downgraded

	To	From
Housing 21		
Issuer Credit Rating	A-/Stable/--	A/Stable/--
Senior Secured	A-	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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.