Research Update:

U.K. Social Housing Provider Housing 21 'A-' Rating Affirmed; Outlook Stable

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Overview

- U.K. social housing provider Housing 21 (H21) has continued to benefit from strong demand for its retirement living and extra care properties across England.
- Although rising inflation puts pressure on H21's financial metrics, we expect that the increase in rental units and annual rent uplift should prevent further weakening.
- We affirmed our 'A-' long-term issuer credit rating on H21.
- The outlook is stable.

Rating Action

On July 25, 2022, S&P Global Ratings affirmed its long-term issuer credit rating on H21 at 'A-'. The outlook is stable.

We also affirmed our 'A-' long-term issue rating on H21's £500 million senior secured bond.

Outlook

The stable outlook reflects our view that H21's increasing rental revenue will alleviate the inflationary pressure on the group's cost base. We project that a gradual improvement of the adjusted non-sales EBITDA will strengthen debt metrics, which counterbalances additional debt intake.

Downside scenario

We could lower the ratings if H21's financial performance does not recover in line with our base case, and we saw a substantial weakening in H21's liquidity position. This could occur if the group increased its spend on development of new homes or existing properties above our expectations. We consider that this could put additional pressure on H21's debt metrics, with interest cover falling to below 1x on a sustained basis.

Upside scenario

Conversely, we could raise the rating on H21 if the group's financial performance recovered quicker than we currently anticipated, supported by proactive actions by the management to contain costs and debt build-up. Under such a scenario, we would expect S&P Global Ratings-adjusted EBITDA margins to structurally rise above 20% and the debt metrics to materially improve on a sustained basis.

Rationale

Our rating affirmation reflects our view that H21 will continue to generate steadily increasing rental revenue from its portfolio of housing for older people, supported by growing demand for this tenure across England. We project the adjusted EBITDA margins to remain relatively low in the fiscal year ending March 31, 2023 (fiscal 2023) because we forecast that costs will increase more than rent, mainly due to rising inflation. We think that additional social rental units and rent increases in the following years will mitigate a higher cost base and forecast that the group's adjusted EBITDA margins will recover, albeit more slowly than in our previous base case. This also reflects our expectation that H21 will maintain the current level of investment in existing properties. We note positively that 99% of H21's units have an energy performance certificate of C or above, and we think the group is better positioned than many of its peers to achieve the environmental targets that the sector aims to meet.

We think the group's continued focus on developing social rental units, which strengthens its non-sales adjusted EBITDA, should have a moderating impact on the group's debt metrics. These weakened following the group's recent £130 million bond tap, of which H21 retains £50 million. H21 has maintained a relatively high level of cash on the balance sheet, so we think the group has sufficient liquidity sources to fund its development without the need to raise new debt until fiscal 2025.

H21 focuses on tenants aged 65 years old and above, benefiting from strong and increasing demand for retirement housing given England's rapidly aging population. We estimate the group's ratio of social to market rents is about 63%. In fiscal 2022, we noted that the group's void losses remained high compared with historical levels, reaching 3.1% of total rent receivable and service charges. We think this increase is temporary because the group had a spike of new home completions in the last two years, which led to a relatively high level of unoccupied units. We expect H21's relet times to improve post the pandemic, leading to a gradual recovery in vacancy rates, which we think will return to below 2% over the next two-to-three years.

We expect that H21's strategy will still largely focus on its retirement and extra care homes, including the provision of extra care services. The group's portfolio remains focused on mainly social rented units for older people, supporting 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. That said, we forecast that H21's exposure to these activities to remain limited, at about 7% of turnover on average over the next two-to-three years.

Like for other English housing associations, we think there is a moderately high likelihood that H21 would receive extraordinary support from the U.K. government in case of financial distress. This provides a one-notch uplift from the stand-alone credit profile. H21's primary purpose is to provide affordable homes, supporting important policy objectives of the U.K. government. We consider that the RSH, a government agency, regulates H21 to promote a viable, efficient, and well-governed social housing sector, and maintain lender confidence and low funding costs across the sector. We therefore think 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.

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 on June 8, 2021).

Liquidity

We consider that H21's liquidity is very strong, underpinned by our view that sources of liquidity will cover uses by nearly 2.5x.

Liquidity sources include:

- Cash and liquid investments of more than £210 million;
- Cash flow from operations of nearly £50 million;
- The undrawn, available portion of committed facilities maturing beyond the next 12 months, totaling more than £50 million; and
- Proceeds from grant receipts and other inflows of more than £45 million.

Liquidity uses include:

- Capex including spend on unit for sales of nearly £105 million; and
- Interest payment and debt repayment of nearly £40 million.

Key Statistics

Table 1

Housing 21--Key Statistics

	--Year ended March 31--				
Mil. £	**2021a**	**2022e**	**2023bc**	**2024bc**	**2025bc**
Number of units owned or managed	21,547	22,204	22,806	23,358	24,279
Adjusted operating revenue	200.9	224.2	240.9	247.7	264.8
Adjusted EBITDA	44.0	26.3	28.7	34.8	42.9
Non-sales adjusted EBITDA	41.7	23.8	26.2	33.7	41.7
Capital expense	86.0	59.5	90.9	146.9	145.0
Debt	672.5	689.0	678.1	666.7	713.1
Interest expense	27.1	27.1	27.9	27.3	28.2
Adjusted EBITDA/Adjusted operating revenue (%)	21.9	11.7	11.9	14.1	16.2
Debt/Non-sales adjusted EBITDA (x)	16.1	29.0	25.9	19.8	17.1
Non-sales adjusted EBITDA/interest coverage(x)	1.5	0.9	0.9	1.2	1.5

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

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

- 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 '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
- Social Housing Outlook 2022: Green Agenda Takes Root In Investment Plans, Nov. 23, 2021
- How U.K. Public Finance Sectors Fare Under Latest Spending Review, Nov. 11, 2021
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings List

Ratings Affirmed	
Housing 21	
Issuer Credit Rating	A-/Stable/--
Senior Secured	A-