S&P Global
Ratings

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Research Update:

U.K.-Based Housing 21 'A-' Ratings Affirmed And Off CreditWatch Negative; Outlook Stable

August 15, 2023

Overview

- On Aug. 10, 2023, Housing 21 (H21) announced it no longer intends to merge with ExtraCare Charitable Trust (ECCT).
- We think that H21 has continued to benefit from strong demand for its retirement living and extra care properties across England.
- We therefore affirmed our 'A-' long-term issuer credit rating on H21 and the 'A-' issue rating on H21's £500 million senior secured bond. At the same time, we removed the ratings from CreditWatch, where they were placed with negative implications on July 27, 2023. The outlook is stable.

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Rating Action

On Aug. 15, 2023, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on Housing 21 (H21) and the 'A-' long-term issue rating on H21's £500 million senior secured bond. We removed the ratings from CreditWatch, where we placed them with negative implications on July 27, 2023. The outlook is stable.

Outlook

The stable outlook reflects our view that H21's increasing rental revenue, supported by strong demand, will offset the risks associated with higher cost pressures and further expansion of its asset base.

Downside scenario

We could lower the rating if the group's financial profile further deteriorated from our current expectations. For example, acquisition and development strategies could result in weaker debt metrics or, should management fail to contain cost pressures, S&P Global Ratings-adjusted EBITDA margins could structurally fall below 10%.

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 substantial recovery in financial metrics. Under such a scenario, we would expect S&P Global Ratings-adjusted EBITDA margins to stay above 20% and a material improvement in debt metrics on a sustained basis.

Rationale

We removed the ratings from CreditWatch with negative implications following the announcement that H21 will not continue pursuing a business combination with ECCT.

The rating affirmation reflects our view that the group will continue to see strong and increasing demand for its services in retirement housing and extra care, which will drive stable and predictable rental revenue and support financial performance. In our view, significant cost pressures due to inflation and investment in existing stock will be somewhat mitigated by rental increases and new units, which will drive revenue growth. We expect that this will lead to continued strengthening of S&P Global Ratings-adjusted nonsales EBITDA over the coming two to three years. That said, we think the increasing capital expenditure (capex) associated with H21's development ambitions will moderately raise its debt intake, pressuring its debt metrics and liquidity.

Enterprise risk profile: Supported by a strong focus on social housing for older people, with limited exposure to sales activities

H21 has a strong focus on its core rental businesses in retirement and extra care homes across England. We understand that most of the group's new units are allocated for social rent to older people. This supports our view that the group will benefit from generating most of its earnings in the predictable and countercyclical social housing sector. We expect that H21 will continue to develop shared ownership homes for sale but project that the exposure to these activities will remain limited at about 5% of adjusted revenue on average over the next two to three years.

Demand for H21's properties is underpinned by strong demographic tailwinds in England, which has a rapidly aging population. We estimate the group's social rent is about 67% of the market rent, which supports demand for its properties. We note that vacancy rates have remained high because the group has been developing and acquiring new units and taken longer than expected to fill them. The three-year average vacancy rate is therefore about 3%, which we consider higher than the sector average but anticipate that it will gradually reduce in the medium term.

We understand that H21's management is scaling back its development aspirations to favor unit acquisitions, similar to those from Clarion and Notting Hill Genesis over the past year. Although this strategy could result in a less predictable financial trajectory, we consider that it also provides capex flexibility, which is positive in view of the need to make necessary investments in existing and newly acquired units. We also note positively that 99% of H21's units have an energy performance certificate of C or above, and we think the group is much better positioned than many of its peers to achieve the sector's environmental targets.

We assess the regulatory framework under which registered providers of social housing in

England operate as strong (see "Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers," published June 8, 2021, on RatingsDirect).

Financial risk profile: Business expansion will constrain the recovery in debt metrics and liquidity, despite stronger rental revenue

We forecast that the group's adjusted EBITDA margins in its housing retirement living and extra care homes will recover more slowly than previously expected. This reflects the inflationary pressure on the cost base and investment in existing stock. Nevertheless, we note that most of its retirement living and extra care units are exempt from the government rent cap in fiscal year 2024 (ending March 31), meaning it can introduce rent increases that fully cover cost inflation. We expect that adjusted EBITDA will still weaken due to the group's one-off payment in fiscal 2024 to support tenants with higher rents. However, we forecast that adjusted EBITDA will strengthen in the years thereafter thanks to the potential rent uplift, which will somewhat compensate for increasing costs. We project that the five-year average adjusted EBITDA margin will be sustained at about 10%. Notwithstanding the low margins, we expect that the group's adjusted nonsales EBITDA will increase, supported by additional rental units from the ongoing development program. In our view, this will alleviate pressure on debt metrics, which we forecast will gradually strengthen through to fiscal 2026.

Nonetheless, we forecast that debt metrics will be weaker than we previously assumed because of the group's plans for acquisitions while its own developments are scaled back. H21 still benefits from the bond tap issues in fiscal 2021 and 2022 at a favorable interest rate compared to the current environment, with cash being used to fund the growth in units. However, increased debt from the bond tap weakened the company's debt metrics, and we expect that it will require further debt funding from fiscal 2025 to meet its development spending.

We view H21's liquidity position as strong, although we see the cash proceeds from the previous bond tap issues were partially used to fund ongoing development. Over the next 12 months, we expect the ratio of liquidity sources to uses will be about 1.5x. We forecast liquidity sources include about £220 million in cash, undrawn and available credit facilities, asset sales, grant receipts, and cash from operations (adding back the noncash cost of sales). This will cover liquidity uses of about £145 million, mainly for capex and debt service payments. We continue to assess H21's access to external liquidity as satisfactory.

Government-related entity analysis

We believe there is a moderately high likelihood that H21 would receive timely extraordinary support from the U.K. government, through the Regulator of Social Housing (RSH) in case of financial distress. This provides a two-notch uplift from the stand-alone credit profile. Given that one of the key goals of the RSH is to maintain lender confidence and low funding costs, we believe it is likely to 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 think this would also apply to H21.

Key Statistics

Table 1

Housing 21--Key statistics

	--Year ended March 31--				
Mil. £	2022a	2023e	2024bc	2025bc	2026bc
Number of units owned or managed	22204	22885	23605	24432	25216
Adjusted operating revenue	224.2	253	273.7	301.7	321.1
Adjusted EBITDA	26	28.5	26.4	35.1	44.4
Nonsales adjusted EBITDA	23.5	24.9	25.5	33.6	42.1
Capital expense	59.5	128.2	82.2	143.2	148.2
Debt	689	680.1	666.7	736.1	826.8
Interest expense	27.1	27.1	27.1	28.6	32.8
Adjusted EBITDA/Adjusted operating revenue (%)	11.6	11.3	9.6	11.6	13.8
Debt/Nonsales adjusted EBITDA (x)	29.3	27.3	26.1	21.9	19.6
Nonsales adjusted EBITDA/interest coverage(x)	0.9	0.9	0.9	1.2	1.3

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

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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

- U.K.-Based Housing 21 'A-' Ratings Placed On CreditWatch Negative On Proposed Merger With ExtraCare Charitable Trust, July 27, 2023
- 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 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; CreditWatch/Outlook Action

	To	From
Housing 21		
Issuer Credit Rating	A-/Stable/--	A-/Watch Neg/--
Housing 21		
Senior Secured	A-	A-/Watch Neg

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,