S&P Global
Ratings

RatingsDirect®

Research Update:

U.K. Social Housing Association East Midlands Housing Group Ltd. 'A+' Rating Affirmed; Outlook Stable

January 19, 2021

Overview

- We forecast that East Midlands Housing Group Ltd.'s (EMH's) S&P Global Ratings-adjusted EBITDA will decrease over the next two years because of increased levels of capitalized repairs, which we expect will weigh on the group's financial performance and debt profile.
- While excess cash will be utilized in the short term, we anticipate that the group's liquidity will remain strong.
- We are affirming our 'A+' long-term issuer credit rating on EMH.
- The stable outlook indicates that EMH will maintain adjusted EBITDA margins of more than 30%, supported by limited exposure to nontraditional activities such as market-related sales and care services under contract.

PRIMARY CREDIT ANALYST

Christopher Mathews
London
+ 44 20 7176 7115
christopher.mathews
@spglobal.com

SECONDARY CONTACT

Luke Linnell
London
luke.linnell
@spglobal.com

ADDITIONAL CONTACT

EMEA Sovereign and IPF
SovereignIPF
@spglobal.com

Rating Action

On Jan. 19, 2021, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K. social housing provider East Midlands Housing Group Ltd. (EMH). The outlook remains stable.

At the same time, we affirmed our 'A+' long-term issue rating on the £200 million senior secured debt issued by EMH's subsidiary, EMH Treasury PLC, and guaranteed by EMH. EMH Treasury was established solely for issuing bonds and lending the proceeds to EMH and we view it as a core subsidiary of EMH.

Rationale

We affirmed our 'A+' rating on EMH because of its strength of strategy, management, liquidity coverage, and limited exposure to market-related sales activities compared with peers. We think that the group's financial performance will be affected by increased capitalized repairs, but S&P Global Ratings-adjusted EBITDA will remain above 30% of revenue. Debt will remain moderate, albeit rising over the forecast period

EMH's limited exposure to sales-related activities, comprising 10% of total revenue across our forecast period, remains a strength compared with peers. However, we estimate that the difference between social and market rent in EMH's areas of operation has narrowed, with our estimated ratio having increased slightly to 70% for fiscal year (FY) ending March 31, 2021, from 69% in FY2020. In addition, according to data from the U.K. Office for National Statistics (ONS), population growth has remained moderate-to-low, at 0.64%.

EMH's strategy and management continues to be a credit strength, in our opinion, with significant experience and tenure in key positions. Development ambitions are modest and in line with capabilities, and EMH has a track record of achieving targets. However, in FY2020, the number of completions fell to 394, compared with our expectation of 463. We anticipate that annual development numbers will recover in the medium term, and we expect EMH to complete a further 1,490 units by FY2023.

Over the forecast period, we expect adjusted EBITDA margins will average 33%, which is unchanged from our previous base case. However, this will likely fall toward 31% by FY2023 as capitalized repairs increase, although it will be partially offset by annual rent increases of Consumer Price Index (CPI)+1% from FY2021. In our view, future capitalized repairs could be higher than forecast, further impairing margins and weighing on financial performance, since management are yet to quantify the potential incremental costs incurred by delivering against the U.K. government's policy of achieving net zero carbon emissions by 2050.

We anticipate that revenue from sales-related activities, predominantly first tranche sales of shared ownership units, will average only 10% of total revenue between FY2021 and FY2023. We view EMH's approach to limiting sales exposure as positive, as it shields the group's revenue base from the volatility of the private sales market, and ensures sustainability of traditional aspects of the business, minimizing reliance on cross-subsidization from riskier products.

In our view, asset quality remains a strength for EMH, supported by the increased capitalized repairs program. EMH reports low vacancy rates of 1.4% and gross arrears fell to 6.1% of rent receivables and related service charges in FY2020. Our forecast prudently assumes an element of rent loss for FY2021 as a result of the countrywide COVID-19-related lockdown, although this is mitigated by a lower level of capitalized repairs, because access to homes has been limited.

EMH's total debt as of FY2020 stood at £457 million, increasing in FY2021 as a result of a £50 million drawing on a previously agreed private placement. We expect EMH will look to utilize excess cash in FY2021 before drawing more debt fromrevolving credit facilities (RCFs) in FY2022 and FY2023 in order to deliver on its development program. We anticipate that adjusted debt to EBITDA will average about 14x between FY2021 and FY2023, up from 12.5x in FY2020. We expect our adjusted EBITDA to interest cover to improve slightly to 1.8x over the same period. EMH's low exposure to sales means that we forecast the adjusted nonsales EBITDA interest cover will be close to that level at 1.7x on average.

As for other English housing associations, we believe there is a moderately high likelihood that EMH would receive extraordinary support in case of financial distress. This is neutral for the rating. EMH'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 EMH 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.

Liquidity

EMH continues to exhibit a very strong liquidity position, and in our view its coverage has strengthened such that sources will cover uses by 2.7x over the next 12 months, up from 2.1x in our previous base case. This reflects EMH securing £175 million of RCFs and drawing a further £50 million from a previously agreed private placement over the past year.

That said, we do expect that EMH will utilize its high liquidity position for its planned capital expenditure over the forecast period, but expect uses will remain comfortably above 2x.

Over the next 12 months, we forecast liquidity sources will amount to £296 million and comprise:

- Cash generated through operations: £44 million;
- Cash and liquid investments: £73 million;
- Proceeds from asset sales: £4 million; and
- Undrawn committed facilities expiring beyond 12 months: £175 million.

We forecast liquidity uses will amount to about £110 million and comprise:

- Capital expenditure: £80 million; and
- Interest and principal repayments: £30 million.

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

Outlook

The stable outlook indicates that EMH will continue to limit exposure to sales activities and keep these below 15% of total revenues. We also expect that the adjusted EBITDA margins will exceed 30% of revenue in the medium term.

We could lower the rating on EMH if the group's adjusted EBITDA deteriorated materially below our forecast due to a higher level of lower margin sales revenue or increasing levels of capitalized repairs. In our view this could lead to adjusted EBITDA margins structurally deteriorating to below 30%, which, in combination with a deterioration in liquidity coverage to below 1.75x, could affect our view of the volatility and risk in EMH's business model.

We could raise the rating if we saw a structural improvement in EBITDA margins to above 40% of revenue, combined with a structural improvement in liquidity, such that sources covered uses by at least 3x.

Key Statistics

Table 1

East Midlands Housing Group Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	**2019a**	**2020a**	**2021e**	**2022bc**	**2023bc**
Number of units owned or managed	20,534	20,820	21,142	21,592	21,983
Revenue§	101.5	108.7	110.1	114.9	123.2

Table 1

East Midlands Housing Group Ltd. Key Statistics (cont.)

	--Year ended March 31--				
(Mil. £)	**2019a**	**2020a**	**2021e**	**2022bc**	**2023bc**
Share of revenue from sales activities (%)	3.0	9.5	9.9	9.1	11.6
EBITDA§†	36.7	37.9	36.0	35.5	38.3
EBITDA/revenue §†(%)	36.1	34.9	32.7	30.9	31.1
Capital expense†	62.4	89.7	67.4	85.0	76.3
Debt	433.8	457.3	502.6	501.8	544.6
Debt/EBITDA §†(x)	11.8	12.1	13.9	14.2	14.2
Interest expense*	19.6	20.9	20.5	21.1	21.5
EBITDA/interest coverage§†* (x)	1.9	1.8	1.8	1.7	1.8
Cash and liquid assets	63.7	57.7	78.5	40.0	40.0

§Adjusted for grant amortization. †Adjusted for capitalized repairs. *Including capitalized interest. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

East Midlands Housing Group Ltd.

Industry risk	2
Economic fundamentals and market dependencies	3
Strategy and management	2
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	3
Debt profile	3
Liquidity	2
Financial policies	2
Financial profile	3

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: Group Rating Methodology, July 1, 2019
- 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
- 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 Score Snapshot: December 2020, Dec. 10, 2020
- Global Social Housing Risk Indicators: 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
- 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
- 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	
East Midlands Housing Group Ltd	
Issuer Credit Rating	A+/Stable/--
EMH Treasury PLC	
Senior Secured	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.