

Research Update:

# U.K. Social Housing Association East Midlands Housing Group Ltd. Downgraded To 'A'; Outlook Stable

January 24, 2024

## Overview

- We expect East Midlands Housing Group Ltd.'s (EMH's) higher investments in existing stock will constrain the improvement we previously projected.
- At the same time, reduced adjusted EBITDA and a continued high level of debt-funded development will weaken EMH's debt metrics.
- We therefore lowered our long-term issuer credit rating on EMH to 'A' from 'A+'.
- The outlook is stable.

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## Rating Action

On Jan. 24, 2024, S&P Global Ratings lowered its long-term issuer credit rating on U.K. social housing provider East Midlands Housing Group Ltd. (EMH) to 'A' from 'A+'. The outlook is stable.

We also lowered our long-term issue rating on the £350 million senior secured debt issued by EMH's subsidiary, EMH Treasury PLC, and guaranteed by EMH to 'A' from 'A+'.

## Outlook

The stable outlook reflects our view that EMH's management team will be able to maintain stable metrics, despite high investment in existing stock through efficient cost management and a proactive approach in grant funding. This would also allow EMH to manage its development program without further weakening of its debt metrics.

## Downside scenario

We could lower the rating on EMH if we observe the group's investment in existing homes is higher

than we projected or if its growth strategy becomes more aggressive. Under this scenario, EMH's credit metrics will be falling below our projections in a sustained manner.

## **Upside scenario**

We could raise the rating on EMH if we see management's actions improving EMH's financial metrics with stronger margins and containing debt build-up.

## **Rationale**

The downgrade reflects our view that EMH's credit metrics will not improve, in contrast to our previous expectations. This is due to high investment in existing stock, weakening the group's adjusted EBITDA, along with increasing debt-funded development. In our view, this will tighten the group's financial position and weaken nonsales EBITDA interest coverage over the next three years. We think that the group's actions to successfully negotiate grants will partly alleviate some of these pressures and will constrain further weakening.

## **Enterprise profile: Supported by focus on traditional social housing activities and management's actions to contain costs**

EMH owns and manages almost 22,000 homes in the East Midlands of England. The demand for social housing properties in the area is strong and will be supported by EMH's average social and affordable rent remaining at about 65% of market rents. In our view, the group's vacancy rate of 1.6% on average over the past three years is on par with the rest of the English social housing sector. The group also benefits from a limited number of market-related sales activities compared with peers, and it is not planning to increase its exposure.

We consider that EMH's management has sufficient expertise and positively access its focus on low-risk activities. Although increased, its development ambitions are aligned with strategy and market conditions and remain in line with those of national peers. We understand that EMH's strategy has been updated to address investments in existing stock to comply with regulatory requirements around stock condition. We estimate that this will result in higher expenditure on maintenance than we previously anticipated. The group has successfully bid for grants, which would allow it to moderately lower these planned expenditures. In addition, EMH has repaid a portion of its liabilities earlier than planned, providing for a decrease in the average cost of debt. We expect that these measures will somewhat offset the pressures to financial and debt metrics.

We assess the regulatory framework under which registered providers of social housing in England operate as strong (see "Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks," published Oct. 23, 2023, on RatingsDirect).

## **Financial profile: The improvement we projected in financial and debt metrics will be hindered by elevated costs and high debt-funded development**

We expect EMH's adjusted EBITDA margins will not recover as we previously projected and will stabilize around 23% over the next three years. This will be largely driven by the need to invest in existing properties to meet EPC C standards by 2030 and by cyclical component replacements. The group has revised its assessment of the related energy efficiency spending after fully completing the stock condition survey. Though these costs will remain high over the next three

years, we don't expect a material deviation from the plan, as EMH has a solid assessment of its stock shape. In our view the external funding for investments coming from grants will partially alleviate pressures on expenditure.

We anticipate that EMH's debt metrics will not recover in line with our previous forecasts. Despite additional grants secured with Homes England, we still project that the group will be funding its development program with additional borrowing. We forecast EBITDA interest coverage will worsen, reflecting the high level of investment in existing stock, which reduces the group's adjusted EBITDA. In addition, a continued high level of debt-funded development will weaken EMH's debt position, which the high interest rate environment would further exacerbate.

We forecast EMH's liquidity position will remain strong. We calculate the group's liquidity sources can cover 2.4x of its uses over the coming 12 months. Sources include £325 million, undrawn available facilities and a secured bond, as well as cash from operations, adding back the noncash cost of sales. The group has roughly £135 million of liquidity uses, primarily comprising capital expenditure, and interest and principal payments. Of EMH's debt, 94% is at a fixed interest rate; therefore, in our view the group has limited exposure to interest rate volatility.

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

## Government-related entity analysis

We believe there is a moderately high likelihood that EMH would receive timely extraordinary government support in case of financial distress. This provides one notch of uplift from the stand-alone credit profile. Because one of the key goals of the Regulator of Social Housing (RSH) 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 the RSH's record of mediating mergers or arranging liquidity support from other registered providers in cases of financial distress and we think this would also apply to EMH.

Table 1

### East Midlands Housing Group Ltd.--Key Statistics

(Mil. £)	--Year ended March 31--				
	2022a	2023a	2024bc	2025bc	2026bc
Number of units owned or managed	21,411	21,795	22,260	22,788	23,159
Adjusted operating revenue	119.2	127.5	142.9	151.5	164.1
Adjusted EBITDA	29.8	28.9	32.6	36.0	37.9
Non-sales adjusted EBITDA	28.3	26.3	29.0	32.8	33.7
Capital expense	65.0	88.0	106.2	107.0	99.6
Debt	492.2	529.6	579.6	634.6	658.5
Interest expense	23.1	24.5	27.3	29.0	28.0
Adjusted EBITDA/Adjusted operating revenue (%)	25.0	22.7	22.8	23.7	23.1
Debt/Non-sales adjusted EBITDA (x)	17.4	20.1	20.0	19.3	19.5
Non-sales adjusted EBITDA/interest coverage(x)	1.22	1.07	1.06	1.13	1.20

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

### East Midlands Housing Group Ltd.--Ratings Score Snapshot

	Assessment
Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	3
Management and governance	3
Financial risk profile	4
Financial performance	4
Debt profile	5
Liquidity	2
Stand-alone credit profile	a-
Issuer credit rating	A

S&P Global Ratings bases its ratings on nonprofit social housing providers on the seven main rating factors listed in the table above. Our "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: Group Rating Methodology, July 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Non-U.S. Social Housing Sector Outlook 2024: At A Turning Point?, Nov. 29, 2023
- Non-U.S. Social Housing Providers Ratings Score Snapshot: November 2023, Nov. 15, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: November 2023, Nov. 15, 2023
- Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks, Oct. 23, 2023
- U.K. Social Housing Providers' Credit Headroom Could Tighten If The Operating Environment

Deteriorates, Oct. 4, 2023

- U.K. Social Housing Borrowing 2023: On Pause, March 28, 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

## Ratings List

### Downgraded; Outlook Action

	To	From
<b>East Midlands Housing Group Ltd</b>		
Issuer Credit Rating	A/Stable/--	A+/Negative/--

### Downgraded

	To	From
<b>EMH Treasury PLC</b>		
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.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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