

Research Update:

# **DRAFT: U.K. Social Housing Association East Midlands Housing Group Ltd. 'A+' Rating Affirmed; Outlook Negative**

January 23, 2023

S&PGR Affirms East Midlands Housing Group At 'A+'; Otlk Neg

## **Overview**

- We expect East Midlands Housing Group Ltd.'s (EMH's) financial performance will come under pressure because of high investments in existing stock and inflationary impact on its cost base.
- We expect the management to moderately scale back its development program and reassess its zero-carbon investments over the next three years.
- We affirmed our long-term issuer credit rating on EMH at 'A+'.
- The negative outlook reflects the risks that EMH's debt metrics might weaken beyond our projections if management fails to implement planned cost-containing measures.

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## **Rating Action**

On Jan. XX, 2023, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K. social housing provider EMH. The outlook remains negative.

At the same time, we affirmed our 'A+' long-term issue rating on the £350 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.

## **Outlook**

The negative outlook reflects the risk that EMH's debt metrics might weaken beyond our projections if management fails to implement planned cost-containing measures.

## Downside scenario

We could lower the rating on EMH over the next 12 months if we observe the group's debt metrics falling below our projections in a sustained manner, absent a sufficient financial policy response.

We could lower the rating if we were to lower our sovereign credit rating on the U.K. or if we revised downward our view of the likelihood of extraordinary support to EMH from the U.K. government in the event of financial distress.

## Upside scenario

We could revise the outlook on EMH to stable if we see management successfully containing its increasing spending and debt build up. This scenario would be contingent on the outlook on the U.K. being revised to stable.

## Rationale

The ratings reflect our view that EMH's focus on traditional social housing activities and contained development will help stabilize its financial and debt metrics. However, the group's increased investment needs in existing stock and inflationary pressures could entail higher-than-anticipated costs. This will tighten the group's financial position and weaken nonsales EBITDA interest coverage over the next three years.

EMH owns and manages more than 21,000 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. The vacancy rates slightly increased to 1.7% from 1.5% in fiscal year ending March 31, 2022, because of the COVID-19 pandemic's impact, but they remain in line with the sector average of 1.6%. 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 given its focus on low-risk activities. Its development ambitions are modest compared with national peers, and the group aligns its strategy with market conditions. For example, EMH has revised down its initial development plan for the next three years to accommodate rising inflationary pressures and rent caps, and reassessed spending related to EPC C costs. We expect that these measures will not fully offset the economic and sector pressures, however, will allow the group to keep their cost base contained.

We expect EMH's adjusted EBITDA margins to remain below 30% in the coming three years. This will be largely driven by the need to invest in existing properties to meet EPC C standards by 2030 and inflation increasing the cost base. The group has revised down the related energy efficiency spending after **doing the elaborate** stock condition survey, however, we expect the costs to remain high over the next three years.

We anticipate that annual development numbers will recover in the medium term, and we expect EMH to return to pre-pandemic levels of unit deliveries, averaging 550 homes annually. Despite the projected increase, we view this growth as moderate, contributing to about 3% of the portfolio annually.

We forecast that the mixture of new debt intake and grant funding will fund new development. EMH's debt metrics will slightly weaken over the coming two years but will then slowly recover,

with debt to nonsales EBITDA remaining below 20x. We forecast EBITDA interest coverage to worsen, reflecting the high level of investment in existing stock and inflationary cost pressures, which reduces the group's EBITDA. Of EMH's debt, 97% is at a fixed interest rate; therefore, in our view the group has limited exposure to interest rate volatility.

We assess the regulatory framework under which registered providers of social housing in England operates as strong (for more information, see "Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers," published June 8, 2021).

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 (SACP). 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.

## Liquidity

We assess EMH's liquidity position as very strong, supported by large undrawn facilities, and deferred and retained bonds. Over the next 12 months, we estimate sources of liquidity will cover uses by 2.5x. We acknowledge the improvement in available sources, but expect moderate weakening to the ratio over the next three years. We continue to view EMH's access to external liquidity as satisfactory.

Sources of liquidity include:

- Cash flow from operations adding back noncash cost of sales of slightly below £50 million;
- **Current cash and liquid investments of roughly £15 million;**
- Fixed-asset sales receipts of slightly above £5 million;
- Committed and undrawn facilities and bond proceeds expiring beyond 12 months of about £240 million; and
- Grant receipt of about £6 million.

We expect uses of liquidity over the same period will include:

- Capital expenditure, including development spending on homes for sale, of about £85 million; and
- Interest and principal repayments of just above £40 million.

Table 1

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

(Mil. £)	--Year ended March 31--				
	2021a	2022a	2023bc	2024bc	2025bc
Number of units owned or managed	21,139	21,411	21,846	22,282	22,697
Adjusted operating revenue	120.2	119.2	129.7	141.3	146.8
Adjusted EBITDA	42.6	29.8	33.1	36.3	42.0
Nonsales adjusted EBITDA	38.8	28.3	29.5	33.4	38.5

Table 1

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

(Mil. £)	--Year ended March 31--				
	2021a	2022a	2023bc	2024bc	2025bc
Capital expense	58.8	65.0	92.1	84.0	80.0
Debt	500.8	492.2	535.3	570.0	587.6
Interest expense	24.0	23.1	25.1	26.9	27.9
Adjusted EBITDA/adjusted operating revenue (%)	35.4	25.0	25.5	25.7	28.6
Debt/nonsales adjusted EBITDA (x)	12.9	17.4	18.2	17.1	15.3
Nonsales adjusted EBITDA/interest coverage(x)	1.6	1.2	1.2	1.2	1.4

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	3
Financial performance	4
Debt profile	4
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: 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
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

## Ratings List

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](http://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](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](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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; or Stockholm (46) 8-440-5914

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