S&P Global Ratings

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Research Update:

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

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- Liquidity at the East Midlands Housing Group Ltd. (EMH) has strengthened over the past year, as a result of two new financing transactions worth a total of £137.5 million.
- Although the rollout of Universal Credit caused gross arrears to increase, we consider management well placed to control this in future.
- We are therefore affirming our 'A+' long-term issuer credit rating on EMH.
- The stable outlook indicates that we still expect EMH to control its exposure to nontraditional activities, including sales.

Rating Action

On Jan. 2, 2020, 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 the ratings because we consider that EMH has consistently focused on its core social housing business. It also has a very strong financial profile with moderate debt levels and has improved its liquidity through two new financing transactions during the past 12 months. A combined £137.5 million was raised to strengthen EMH's liquidity position as it pursues its goal of developing 2,500 homes by 2023.

Supporting the 'A+' rating on EMH is the low-risk industry in which it operates and its decision to focus on traditional activities. EMH operates across the East Midlands region, in England. In this region, population growth stands at 0.6% and weekly social rents average around 70% of private rents. In our opinion, these factors make the East Midlands a slightly less dynamic region for a social housing association to operate in than London and the southeast of England.

The financial year ending March 31, 2019 (FY2019) was tougher for EMH, in terms of operational performance. In the previous three years, EMH had consistently reduced vacancy rates. However, in FY2019, vacancy rates increased marginally to 1.4%, up from 1.2% the year before. This is still below the typical level for the sector of 2%.

In the same period, gross arrears increased to 6.6% of rent and service charge receivables, up from 5.3% the year before. We attribute this to the rollout of Universal Credit, combined with an element relating to former tenants. EMH is using its Trusted Partnership status with the Department of Work and Pensions to keep on top of arrears. At present, we do not consider that the increase in gross arrears to over 6% has materially weakened EMH's enterprise profile assessment.

EMH successfully completed around 420 general needs and shared ownership homes in FY2019--nearly 100 units more than we had expected. Over the next three years to FY2022, we forecast EMH will record nearly 1,400 completions, of which nearly 500 will be for shared ownership. Factoring in disposals, we expect EMH's asset base to grow to nearly 21,500 units, owned and managed, by FY2022.

An increase in capitalized repairs and shared ownership first-tranche sales will weigh on financial performance for FY2020, with S&P Global Ratings-adjusted EBITDA margins forecast to fall to 33% from 36% recorded in FY2019. However, planned growth in EMH's asset base, combined with the ability to increase rents by consumer price index (CPI) plus 1% from FY2021 onward will help increase adjusted EBITDA margins. We therefore expect EBITDA margins to build slowly to about 34% by FY2022.

Notably, revenue from sales-related activities will average only 8% of total revenue between FY2020 and FY2022. We view EMH's management of its sales exposure as positive, as it shields its revenue base from the volatility of the private sales market.

EMH's total debt as of FY2019 stood at £433 million. Its debt increased because of its new £37.5 million facility with MORHomes and we expect EMH to make further debt drawings in FY2020 and FY2021 to help facilitate its development ambitions. Adjusted debt to EBITDA is likely to average 12.5x between FY2020 and FY2022, slightly up from the 11.8x recorded in FY2019. We expect our adjusted EBITDA to interest cover to remain stable at 1.7x over the same period. EMH's low exposure to sales means that nonsales EBITDA interest cover is also likely to average 1.7x.

The 'A+' rating on EMH mirrors its stand-alone credit profile, based on our view there is a moderately high likelihood that the U.K. government, working through the Regulator of Social Housing, would provide timely and sufficient extraordinary support in the event of financial distress. We consider that EMH plays an important role in the provision of social housing for the U.K. government and has a strong link to the government, which has demonstrated a track record of supporting the sector.

Liquidity

EMH's liquidity has improved over the past 12 months due to the £37.5 million MORHomes facility and a £100 million private placement. These transactions have increased liquidity sources to around £220 million, up £65 million from last year. We forecast EMH's liquidity sources will cover uses by 2.3x over the next 12 months. Of EMH's private placement, £50 million is deferred until next year and is not yet fully secured. Therefore, we have not factored this into EMH's liquidity assessment.

We forecast liquidity sources will amount to £221 million and comprise:

- Cash generated through operations: £37 million

- Cash and liquid investments: £77 million
- Proceeds from asset sales: £7 million
- Undrawn committed facilities: £100 million

We forecast uses of liquidity will amount to around £96 million and comprise:

- Capital expenditure: £66 million
- Interest and principal repayments: £30 million

Outlook

The stable outlook indicates that we expect EMH to control its exposure to nontraditional activities, including sales, and to retain a strong operational performance, especially the management of arrears.

We could lower the rating on EMH if its liquidity position deteriorated markedly, such that liquidity sources could not cover uses by at least 1x.

We could raise the rating if we saw an improvement in EMH's financial performance, such that adjusted EBITDA margins structurally improved toward 40%. At the same time, we would expect to see a structural improvement in liquidity, such that sources covered uses by at least 3x.

Table 1

East Midlands Housing Group Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	2018a	2019a	2020e	2021bc	2022bc
Number of units owned or managed	20,124	20,534	20,827	21,145	21,419
Revenue*	99.3	101.5	107.8	111.5	119.8
Share of revenue from sales activities (%)	3.0	3.0	8.0	7.0	10.0
EBITDA*§	36.6	36.7	35.8	37.7	40.9
EBITDA/revenue*§(%)	36.8	36.1	33.2	33.8	34.1
Capital expense§	33.9	62.4	85.3	59.6	70.4
Debt	383.9	433.8	448.5	482.0	483.4
Debt/EBITDA*§(x)	10.5	11.8	12.5	12.8	11.8
Interest expense†	20.5	19.6	20.8	22.1	22.9
EBITDA/interest coverage*§† (x)	1.8	1.9	1.7	1.7	1.8
Cash and liquid assets	25.2	63.7	42.1	56.9	25.0

*Adjusted for grant amortization. §Adjusted for capitalized repairs. †Including capitalized interest. a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. e--Estimate. N.A.--Not available.

Table 2

East Midlands Housing Group Ratings Score Snapshot

Industry risk	2
Economic fundamentals and market dependencies	3

Table 2

East Midlands Housing Group Ratings Score Snapshot (cont.)

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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- United Kingdom Outlook Revised To Stable; 'AA/A-1+' Ratings Affirmed, Dec. 17, 2019
- Why Most Rated U.K. Social Housing Providers Are At Home In The 'A' Category, Dec. 3, 2019
- Global Social Housing Ratings Score Snapshot: December 2019, Dec. 2, 2019
- Global Social Housing Risk Indicators: December 2019, Dec. 2, 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.

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