

# Housing 21

August 5, 2024

This report does not constitute a rating action.

## Credit Highlights

### Overview

Enterprise profile	Financial profile
In our view, Housing 21 (H21) benefits from strong demand and a focus on traditional social housing activities in retirement and extra care homes across England.	We project that financial metrics will recover through fiscal 2027 (ending March 31) but gradually given investment in both existing and new homes.
H21's focus on social rent activities for the elderly, with limited exposure to sales, should provide predictable revenue.	We think that H21's rental income will increase on the back of development and acquisition, in combination with rent increases. This, along with control on costs, will alleviate the cost pressures from investment in existing and newly acquired units.
We consider demand for its services as strong on the back of the aging population in the U.K. This should help improve the vacancy rates, which are relatively higher than rated peers focusing on retirement housing.	We expect that the group will take on new debt to support its growth strategy but will reprofile the pipeline in times of pressure on the debt burden.
We view that management's unit acquisition strategy is balanced by the prudent approach to manage cost pressures, which contributes to a slow recovery of the financial metrics.	We estimate liquidity to remain strong, backed by undrawn facilities and potential cash proceeds from its retained bond if sold.

**We expect that H21 will benefit from strong and increasing demand for its services in retirement and extra care homes, which will generate a stable and predictable rental revenue and support the financial performance.** We see cost pressures from investment in both existing and newly acquired homes together with cost inflation. However, rent increases will mitigate these pressures, which will drive the revenue growth. The group is also taking measures to enhance cost efficiency including reviewing its care contracts and noncore segments. In our view, this will lead to a recovery of the S&P Global Ratings-adjusted EBITDA margin to above 10% in the next two to three years.

**We think that the group will develop and acquire units, but we expect that it will reprofile its pipeline if it sees financial pressure.** Although the capital expenditure (capex) associated with H21's growth plan will require new debt intake, we expect that the rental revenue from the additional units will contribute to strengthen adjusted nonsales EBITDA, and hence its debt metrics.

### Primary contact

**Tim Chow, CFA**  
London  
44-2071760684  
tim.chow  
@spglobal.com

### Secondary contact

**Noa Fux**  
London  
44-20-7176-0730  
noa.fux  
@spglobal.com

## 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 the 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

### **Enterprise profile: Strong demand for its services for the elderly and a focus on its core rental business provides stability to its rental income**

H21 focuses on its core rental businesses in retirement and extra care homes across England. We understand that most of the group's existing and new units are allocated for social rent to older people, which underpins 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 contain its sales activities to shared ownership homes and project that the exposure to these activities will remain limited within 5% of adjusted revenue on average over the next two to three years.

We favorably view the strong demand for H21's properties given the rapidly aging population in England. We also think that the group's social rent in its retirement homes at about 73% of the market rent will further support the demand for its properties. The vacancy rates have remained high because it has taken longer-than-expected to fill the newly developed and acquired units. The three-year average vacancy rate is about 2.6%. However, we expect that the level is gradually improving toward the level of rated peers which focus on retirement housing, considering the group's effort to expedite the reletting of the units.

We understand that the group favors acquisition of units as part of its growth strategy. In our view, although this strategy could result in a less predictable financial trajectory, it will provide financial flexibility in capex, which is helpful given the cost pressure from investment in both existing and recently acquired homes. The conditions and risks of the units obtained through acquisitions may not be entirely up to the group's standards, but we believe the management will ensure the units are financially viable and stick to its core businesses in new developments and acquisitions not engaging in activities that increase material risks to the group's operations. We also think that the group will reprofile the growth pipeline to lessen the pressure on financial

metrics if needed. In addition, we view the group's achievement of about 99% of its existing stock above an Energy Performance Certificate C standard as positive, which gives H21 an advantage compared with 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 "Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks," published Oct. 23, 2023 on RatingsDirect)

### **Financial profile: Rent increases and cost saving measures will somewhat mitigate cost pressures, leading to a gradual recovery in financial metrics**

The group's adjusted margins are lower compared with peers in the sector given the nature of the retirement business with costly care service provision. We forecast that the group's adjusted EBITDA margins will gradually recover, although slightly slower than previously expected. We think that investment in both existing homes and newly acquired homes due to H21's acquisition strategy will slow down EBITDA recovery. The strategy includes costs to bring new units up to H21's standards. We noted that the group has a payment in fiscal 2024 to support tenants with higher rents and we think that it will invest to maintain customer satisfaction. However, we expect that adjusted EBITDA margins will still be on an improving trajectory, given the group's rent increases and additional rental units that drive the revenue growth. We think that the group is taking actions to improve cost efficiency and resource allocation. This includes the group's actions to review its loss-making care contracts and noncore portfolio that aims to generate more financial headroom.

We anticipate that debt metrics will gradually improve despite new developments and acquisitions. Although the group's growth strategy requires new debt intake, our forecast incorporates the additional rental revenue from the newly acquired units as well as from the group's developed new units, which will strengthen the group's rental revenue base, further boosted by the rent increase. This will support a recovery of debt metrics. We recognize that the group has certain flexibility in the pipeline, especially acquisitions, to scale back if needed. The group has been relying on the £450 million bond drawdown to support its developments and acquisitions, and we expect that H21 will increase its variable rate exposure.

We view H21's liquidity position as strong, and expect that the group will strengthen funding to support its growth strategy. Over the next 12 months, we anticipate that the ratio of liquidity sources to uses will be about 1.4x. We forecast liquidity sources to include about £345 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 £250 million, mainly for capex and debt service payments. We 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 think that 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

### Housing 21--Key statistics

Mil. £	--Year ended March 31--				
	2023a	2024e	2025bc	2026bc	2027bc
Number of units owned or managed	22,885	23,458	24,035	24,580	25,172
Adjusted operating revenue	250.8	277.6	300.3	326.5	352.2
Adjusted EBITDA	27.2	27.4	34.5	38.6	43.3
Nonsales adjusted EBITDA	23.5	25.9	33.6	37.5	41.8
Capital expense	128.3	67.3	184.6	84.1	94.7
Debt	680.1	666.8	761.1	800.8	840.9
Interest expense	27.1	26.5	32.5	31.9	33.1
Adjusted EBITDA/Adjusted operating revenue (%)	10.8	9.9	11.5	11.8	12.3
Debt/Nonsales adjusted EBITDA (x)	28.9	25.8	22.7	21.3	20.1
Nonsales adjusted EBITDA/interest coverage(x)	0.9	1.0	1.0	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.

## Rating Component Scores

### Housing 21--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	5
Debt profile	5
Liquidity	3
Stand-alone credit profile	bbb
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

## Housing 21

- 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

## Related Research

- United Kingdom, April 22, 2024
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2024, March 11, 2024
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2024, March 11, 2024
- Non-U.S. Social Housing Providers Ratings History: March 2024, March 11, 2024
- U.K. Social Housing Borrowing 2024: Borrowing capacity remains constrained, March 6, 2024
- European Housing Markets: Forecast Brightens Amid Ongoing Correction, Jan. 25, 2024
- Non-U.S. Social Housing Sector Outlook 2024: At A Turning Point? , Nov. 29, 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 Providers Set Their Sights On Cyber Risks, Dec. 16, 2022

### Ratings Detail (as of August 05, 2024)\*

#### Housing 21

Issuer Credit Rating	A-/Stable/--
Senior Secured	A-

#### Issuer Credit Ratings History

15-Aug-2023	A-/Stable/--
27-Jul-2023	A-/Watch Neg/--
23-Jul-2021	A-/Stable/--

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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