

Research Update:

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

January 21, 2025

Overview

- We project that despite high investments in existing stock, East Midlands Housing Group Ltd. (EMH) will maintain stable financial metrics, supported by management's mitigating measures, and rent increases outpacing cost growth.
- We expect prudent cost management and secured grant funding will allow EMH to control debt increase without weakening credit metrics.
- We therefore affirmed our 'A' long-term issuer credit rating on EMH. The outlook is stable.

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Rating Action

On Jan. 21, 2025, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on U.K. social housing provider East Midlands Housing Group Ltd. The outlook is stable.

We also affirmed our 'A' issue rating on the £350 million senior secured debt issued by EMH Treasury PLC, which we view as a core subsidiary of the group.

Outlook

The stable outlook reflects our view that EMH will be able to manage risks associated with its large investment program in existing stock, thanks to successful grant acquisition and prudent cost management policies. This will result in the group's financial indicators remaining largely stable over our base case, despite the debt buildup.

Downside scenario

We could lower the rating on EMH if we observe loosened control over costs or if the group increases its debt-funded development on new homes. Under this scenario, adjusted EBITDA

would weaken to structurally below 20% and adjusted EBITDA interest coverage would fall to markedly below 1x on a sustained basis.

Upside scenario

We could raise the rating on EMH if we see management's actions resulting in improved financial metrics, with accelerated recovery in the group's adjusted EBITDA and debt metrics that outpace our base-case expectations on a sustained basis.

Rationale

The rating affirmation reflects our view that EMH's prudent cost planning and improvement in economic conditions will help to stabilize financial metrics despite increased investments in existing homes. We acknowledge the group has a solid assessment of its stock condition and has secured grant funding to perform the necessary works. We also think group's proactive approach in securing development grants will partly lower borrowing needs, preventing debt metrics from weakening.

Enterprise profile: Supported by a focus on traditional social housing activities and proactive cost management

We think EMH benefits from generating most of its earnings in the predictable and countercyclical social housing sector, supported by its solid regional market position and generally low exposure to sales. EMH owns and manages more than 22,000 homes in the East Midlands region of England. The demand for social housing properties in the area is strong, evidenced by the group's average vacancy rate of 1.6% over the past three years, which is on par with the rest of the English social housing sector. We also think the group's social and affordable rents, which we estimate to be just below 70% of the market average rent across the area of operations, provide property affordability and support demand.

We consider EMH's management to have sufficient expertise in the housing sector. We view positively its focus on low-risk activities, improved control over property stock, and solid treasury policies. We understand the group's strategy prioritizes improving the quality of its existing homes to meet regulatory requirements and achieve an Energy Performance Certificate (EPC) level C by 2030. About 65% of the stock is at EPC C or above, and the group has successfully secured grants to help fund investments in existing homes. In addition, EMH has been proactive in securing capital grants, which will support development targets over the next three years and stabilize 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: Stable financial metrics underpin our assessment despite large investments and debt buildup

We expect EMH's S&P Global Ratings-adjusted EBITDA margins will remain just over 20% over the next three years, due to large investments in existing stock together with high demand for repairs and maintenance. We project the secured grant funding for these investments will partially

alleviate pressures on expenditure. In addition, an expanding asset base and increase in rental revenues that outpace cost inflation will allow adjusted EBITDA to slowly recover by fiscal year 2027 (ending March 31, 2027), although it will be slightly weaker than our previous expectations.

We project EMH's growing development program will result in a modest increase in debt. Despite substantial grants secured with Homes England, we still expect the group will fund its development program with additional borrowing. We therefore expect the debt ratio to remain above 20.0x, and interest coverage at about 1.1x over the next three years.

We forecast EMH's liquidity position will remain strong. We calculate the group's liquidity sources can cover 2.6x of its uses over the coming 12 months. Sources include £345 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 in liquidity uses, primarily comprising capital expenditure and interest and principal payments. We continue to view EMH's access to external liquidity as satisfactory.

Government-related entity analysis

We think there is a moderately high likelihood that EMH would receive timely extraordinary government support in the event of financial distress. This provides a one-notch uplift from the stand-alone credit profile. Since 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 consider it likely that the RSH would step in and 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-- | | | | |
|--|-------------------------|--------|--------|--------|--------|
| | 2023a | 2024a | 2025bc | 2026bc | 2027bc |
| Number of units owned or managed | 21,795 | 22,108 | 22,423 | 22,822 | 23,185 |
| Adjusted operating revenue | 127.5 | 144.9 | 147.8 | 157.0 | 164.5 |
| Adjusted EBITDA | 28.9 | 27.7 | 32.2 | 32.3 | 35.0 |
| Non-sales adjusted EBITDA | 26.3 | 24.0 | 29.9 | 29.3 | 31.9 |
| Capital expense | 88.0 | 91.6 | 92.8 | 105.9 | 78.0 |
| Debt | 529.6 | 593.8 | 608.5 | 675.5 | 720.5 |
| Interest expense | 24.5 | 27.0 | 26.7 | 28.1 | 29.5 |
| Adjusted EBITDA/Adjusted operating revenue (%) | 22.7 | 19.1 | 21.8 | 20.5 | 21.3 |
| Debt/Non-sales adjusted EBITDA (x) | 20.1 | 24.7 | 20.4 | 23.1 | 22.6 |
| Non-sales adjusted EBITDA/interest coverage(x) | 1.1 | 0.9 | 1.1 | 1.0 | 1.1 |

a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

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 2025: Quality Maintenance Constrains Recovery, Jan. 14, 2025
- The Autumn Budget Kicks Off A Funding Regime Revision For U.K. Public Sector Entities, Nov. 5, 2024
- U.K. Social Housing Providers' Financial Capacity Shrinks On Investment Needs, Nov. 4, 2024
- Non-U.S. Social Housing Providers Ratings Risk Indicators: Ratings Pressure Has Eased, Oct. 31, 2024
- Non-U.S. Social Housing Providers Ratings History: October 2024, Oct. 31, 2024
- Cyber Risk Brief: U.K. Public Sector Is Increasingly Under Threat, Oct. 24, 2024

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.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. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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