Research Update:

U.K.-Based Social Housing Provider Futures Housing Group Outlook Revised To Negative; 'A+' Rating Affirmed

October 11, 2023

PRIMARY CREDIT ANALYST

Colleen Sheridan
London
+44-20-7176-0561
colleen.sheridan
@spglobal.com

SECONDARY CONTACT

Abril A Canizares
London
+ 44 20 7176 0161
abril.canizares
@spglobal.com

ADDITIONAL CONTACT

Sovereign and IPF EMEA
SOVIPF
@spglobal.com

Overview

- We expect Futures Housing Group's (FHG's) financial position to strengthen over the next 24 months as rent growth outpaces inflation and management contains development and repays debt.
- However, higher investments in existing properties to meet decarbonization targets will weigh on FHG's S&P Global Ratings-adjusted EBITDA and delay the previously expected improvement in debt metrics.
- We revised the outlook on the long-term issuer credit rating on FHG to negative from stable to reflect the risk that management might not be able to implement its strategy and strengthen metrics as we expect.
- At the same time, we affirmed the 'A+' issuer credit rating on FHG.

Rating Action

On Oct. 11, 2023, S&P Global Ratings revised its outlook on the long-term rating on U.K. social housing provider FHG to negative from stable. At the same time, we affirmed our 'A+' long-term issuer credit rating.

We also affirmed our 'A+' issue rating on the £270 million bond issued in February 2019 by Futures Treasury PLC, the group's funding vehicle set up for the sole purpose of issuing bonds and lending the proceeds to FHG.

Outlook

The negative outlook reflects the risk that higher-than-anticipated investments in existing homes coupled with inflationary pressures could hamper the improvement we currently expect in FHG's financial metrics.

Downside scenario

We could lower the rating on FHG if over the next two years management adopts a more aggressive strategy, leading to financial metrics materially weaker than our current projections.

Upside scenario

We could revise the outlook to stable if FHG successfully improves metrics in line with our forecasts and maintains strong liquidity.

Rationale

The outlook revision reflects our view that FHG's increased investment in existing stock, alongside general inflationary pressure, will entail higher costs than we previously anticipated. Under our updated projections, we anticipate investment in existing stock will be above historical averages. Although the increase in investments will weigh on adjusted EBITDA, we expect financial metrics will improve over the next 24 months as rent is forecast to grow faster than inflation, and as FHG manages its new development spend. Additionally, we expect FHG to continue to benefit from solid demand and a relatively supportive regulatory framework.

Enterprise profile: Underpinned by predictable and countercyclical earnings with limited exposure to sales risk and strong management

FHG benefits from generating most of its earnings in the predictable and countercyclical English social-housing sector, with less than 15% of its adjusted operating income from sales activity related to shared ownership. The group no longer plans to develop units for outright sales--unless to achieve mixed tenure for grant funding--from fiscal year 2023 (ending March 31, 2023) onward. The group owns and manages about 10,500 homes in the East Midlands in England and continues to see strong demand for its properties. FHG's average social and affordable rents are about 65% of the average market rent in the region, and its vacancy rates averaged 1.2% over the past three years, which we consider at par with the sector average.

We view management as experienced and stable with strong expertise to deliver on its strategy to strengthen debt metrics. We believe FHG is prudently managing risks and maintaining flexibility in its development plan. We believe management's actions in recent years, including securing capital in fiscal 2022 to prefund development, provide some capacity to withstand challenges. In our view, FHG benefits from its stock profile, with no properties higher than 18 meters and limited need for fire safety remediation work. However, we acknowledge that FHG's share of stock at the Energy Performance Certificate C level and above is lower than the sector average. Therefore, we think the spend to achieve its 2030 targets will weigh on the group's financial performance over the next two years.

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

Financial profile: Solid liquidity and contained development will support our projected metrics amid higher levels of investments in existing homes

We expect FHG's adjusted EBITDA margins will remain closer to 20% over the next 24 months, due to increased investments in existing stock and inflation exacerbating maintenance and repair costs. Although FHG's financial performance is below historical levels, margins are in line with the current rating and expected to improve as growth in rent is forecast to exceed inflation. Still, with lower adjusted EBITDA expectations, we forecast FHG's debt to nonsales EBITDA to remain elevated, gradually improving below 20x by 2026. Weakness in adjusted EBITDA also extends to nonsales interest coverage, despite FHG eliminating interest rate risk by fixing its entire capital structure.

Although we forecast weaker debt profile metrics, management has taken action including reducing capital expenditure (capex) and prepaying debt to buffer the full brunt of the lower adjusted EBITDA that is pressured by investments in existing stock and higher demand for maintenance. We forecast FHG's debt balance to reduce over fiscals 2024 and 2025 with the next funding requirement not until fiscal 2026.

We forecast FHG's liquidity position will remain very strong over the next 12 months, even as cash is deployed toward capex and debt service payments. We estimate the group's liquidity sources will cover uses by approximately 2.0x in the next 12 months. This is based on our forecast of liquidity sources of about £121.4 million comprising cash, undrawn and available revolving credit facilities, asset sales, grant receipts, and cash from operations (adding back the noncash cost of sales) that will cover liquidity uses of about £61 million (mainly capex and debt service payments). We also assume FHG will continue to have satisfactory access to debt capital markets.

Government-related entity analysis

In our view, there is a moderately high likelihood that FHG would receive timely extraordinary government-related support in case of financial distress. This leads us to apply a one-notch uplift to our assessment of FHG's stand-alone credit profile to derive the issuer credit rating. Since one of the Regulator for Social Housing's (RSH's) key goals is to maintain lender confidence and low funding costs across the sector, we think it is likely that the RSH would try to prevent a default in the sector. We base this view on RSH's track 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 FHG.

Key Statistics

Table 1

Futures Housing Group--Key statistics

	--Year ended March 31--				
Mil. £	**2022a**	**2023a**	**2024bc**	**2025bc**	**2026bc**
Number of units owned or managed	10398	10502	10674	10927	11162
Adjusted operating revenue	58.8	58.8	68.5	68.6	71.9
Adjusted EBITDA	15.9	11.6	14.0	13.3	16.6
Nonsales adjusted EBITDA	15.4	11.5	13.7	13.1	16.4
Capital expense	27.8	26.6	38.3	38.0	37.6
Debt	336.8	317.8	292.9	292.9	305.4
Interest expense	10.2	11.9	11.3	10.5	10.8

Table 1

Futures Housing Group--Key statistics (cont.)

	--Year ended March 31--				
Mil. £	2022a	2023a	2024bc	2025bc	2026bc
Adjusted EBITDA/Adjusted operating revenue (%)	27.0	19.8	20.5	19.4	23.1
Debt/Nonsales adjusted EBITDA (x)	21.9	27.6	21.4	22.3	18.6
Nonsales adjusted EBITDA/interest coverage(x)	1.5	1.0	1.2	1.2	1.5

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

Ratings Score Snapshot

Table 2

Futures Housing Group--Ratings score snapshot

	Assessment
Enterprise risk profile	2
Industry risk	2
Regulatory framework	3
Market dependencies	3
Management and governance	2
Financial risk profile	4
Financial performance	4
Debt profile	5
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

Related Research

- United Kingdom Outlook Revised To Stable From Negative On Moderating Fiscal Risks; 'AA/A-1+' Ratings Affirmed, April 21, 2023
- U.K. Social Housing Borrowing 2023: On Pause, March 28, 2023
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2023, March 27, 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
- Non-U.S. Social Housing Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022
- Inflation To Erode The Performance Of U.K. Public Finance Sectors, Nov. 29, 2022
- Cap On Rent Increases Is Consistent With Our Base Case For English Social Housing Providers, Nov. 17, 2022
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 2022
- Launch Of Rent Cap Consultation Adds Uncertainty To Creditworthiness Across English Housing Sector, Sept. 1, 2022
- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings List

Ratings Affirmed		
Futures Treasury PLC		
Senior Secured	A+	
Ratings Affirmed; Outlook Action		
	To	**From**
Futures Housing Group		
Issuer Credit Rating	A+/Negative/--	A+/Stable/--