Research Update:

U.K.-Based Social Housing Provider Stonewater Ltd. Downgraded To 'A-'; Outlook Stable

November 27, 2024

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Overview

- We forecast that U.K. social housing provider Stonewater Ltd.'s investment in its properties will weaken debt metrics and further delay the recovery we expected previously.
- In line with our previous expectations, Stonewater will scale back its new homes development program, which we believe will lead to contained debt buildup.
- Nevertheless, Stonewater's debt metrics are lower than we previously assumed and potential recovery has been delayed.
- We therefore lowered our issuer credit rating on Stonewater Ltd. to 'A-' from 'A'. The outlook is stable.

Rating Action

On Nov. 27, 2024, S&P Global Ratings lowered its long-term issuer credit rating on Stonewater Ltd. to 'A-' from 'A'. The outlook is stable.

We also lowered our issue ratings to 'A-' from 'A' on the three senior secured bonds issued by Stonewater Funding PLC, and on Stonewater Funding's £1 billion senior secured and unsecured medium-term notes program. We consider that Stonewater Funding was set up for the sole purpose of issuing bonds and lending the proceeds to the group, and we view it as a core subsidiary of Stonewater.

Outlook

The stable outlook reflects that the scaling back of new home construction will contain the debt buildup, mitigating the pressure from a high level of investment in existing homes.

Downside scenario

We could lower the rating if Stonewater cannot efficiently rein in costs, or if it significantly expands its development ambitions beyond the current forecasts, so that the financial metrics are markedly weaker than our current base-case expectations. Under such a scenario, we expect that S&P Global Ratings-adjusted EBITDA margins will materially weaken and adjusted non-sales EBITDA interest coverage will fall well below 1x on a sustained basis.

Upside scenario

We could raise the rating if the cost control program is delivered efficiently and the group contains debt buildup. We consider this could lead to a faster improvement in the group's financial metrics than our forecasts, such that the group's debt metrics strengthen on a sustained basis, all else being equal.

Rationale

The downgrade reflects our view that the group's level of investment in existing homes will remain elevated, which, in combination with higher-than-anticipated debt levels, has resulted in weaker debt metrics and in turn has delayed the improvement we previously forecast. We expect potential grant funding for investment in existing homes and management's focus on cost efficiencies will to some extent prevent the group's credit metrics from deteriorating further. Furthermore, we think that the group's strategy to scale back its developments will lessen the pressure because it will contain the debt buildup in our view, but the recovery will be modest.

Enterprise profile: Stonewater's strong focus on traditional social housing letting underpins its credit quality.

Stonewater benefits from generating most of its earnings in the predictable and countercyclical social housing sector. The group's sales exposure is predominately shared ownership sales. We forecast that the group will contain its exposure to sales income, at about a moderate 16% of the group's adjusted revenue on average in the coming two to three years.

We consider that the demand for Stonewater's properties remains strong. This is supported by the group's social and affordable rent remaining at a fairly low level of about 67% of the market rent. The strong demand is also evident in the group's vacancy rate, which has averaged at about 1.0% of the rent and service charge receivable over the past three years and which we consider to be on par with the sector in England.

In our view, the group's board and executive team has solid experience and expertise in its operations and we understand that the group is taking actions to mitigate the pressure from economic and regulatory external factors and increased demand for services from tenants. Also, we expect that Stonewater will contain its expansion plans, while focusing on strengthening its financial resilience. We think these actions will be positive but will lead to a slower recovery from the currently weak position.

We assess the regulatory framework, under which registered social housing providers in England operate, as strong (for more information see "Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks," published Oct. 23, 2023).

Financial profile: Stonewater's investment in existing homes will slow the potential recovery of the financial metrics

We project that the group will have weaker debt metrics than we previously anticipated due to pressure from investment in existing homes and higher-than-expected debt levels. The level of spending on maintaining and repairing existing homes has risen in the past two years and has weakened the non-sales-adjusted EBITDA to below the level we expected. In our view, the level will remain high, considering the group's focus on asset quality, potentially supported by grant funding.

We think the investment in existing homes has weakened the group's adjusted EBITDA margins. Although we forecast that the group will increase rent that exceeds inflation and achieve some cost savings, we estimate that the recovery of the margins will be more modest than we previously assumed.

We forecast that debt and interest costs will increase through fiscal year 2027, leading to a slow recovery of debt metrics. As previously projected, we understand that the group will reduce development, containing the debt buildup. This follows a relatively high level of capital expenditure in fiscal 2024 (ended March 31, 2024), which resulted in higher debt than we had forecast. Meanwhile, the grant funding through the Strategic Partnership Program with Homes England and the disposal proceeds arising from the group's asset management program will underpin our forecast of a gradual debt buildup.

We view Stonewater's liquidity as strong. The group's liquidity sources cover uses by approximately 1.9x in the next 12 months. This is based on our forecast of liquidity sources of about £535 million--comprising cash, undrawn and available revolving credit facilities, fixed asset sales, grant receipts, and cash from operations (adding back the noncash cost of sales)--which will cover liquidity uses of about £285 million (mainly capital expenditure and debt service payments). At the same time, we believe Stonewater retains satisfactory access to external liquidity when needed.

Government-related entity analysis

We believe there is a moderately high likelihood that Stonewater 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 one-notch uplift from the stand-alone credit profile. As one of the key goals of the 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 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 Stonewater.

Selected Indicators

Table 1

Stonewater Ltd.--Financial statistics

	--Year ended Mar. 31--				
Mil. £	**2023a**	**2024a***	**2025bc**	**2026bc**	**2027bc**
Number of units owned or managed	36,981	39,488	40,383	41,142	41,894
Adjusted operating revenue	231.7	263.5	303.9	330.7	341.1
Adjusted EBITDA	55.9	53.6	68.4	84.4	88.2
Nonsales adjusted EBITDA	50.4	48.9	64.3	80.1	84.5

Table 1

Stonewater Ltd.--Financial statistics (cont.)

	--Year ended Mar. 31--				
Mil. £	2023a	2024a*	2025bc	2026bc	2027bc
Capital expense	199.2	304.5	211.7	186.6	140.7
Debt	1,384.1	1,602.1	1,711.5	1,775.4	1,786.0
Interest expense	46.6	58.4	69.0	67.7	68.4
Adjusted EBITDA/Adjusted operating revenue (%)	24.1	20.4	22.5	25.5	25.8
Debt/Nonsales adjusted EBITDA (x)	27.4	32.8	26.6	22.2	21.1
Nonsales adjusted EBITDA/interest coverage(x)	1.1	0.8	0.9	1.2	1.2

*Includes two months of Mount Green Housing Association.

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

Stonewater 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	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
- 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

- 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
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 18, 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

Ratings List

Downgraded

	To	From
Stonewater Funding PLC		
Senior Secured	A-	A

Downgraded;Outlook Action

	To	From
Stonewater Ltd.		
Issuer Credit Rating	A-/Stable/--	A/Negative/--

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/sourceId/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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