

CREDIT OPINION

21 October 2024

Update

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RATINGS

Sovereign Network Group

Domicile	London, United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Sovereign Network Group (UK)

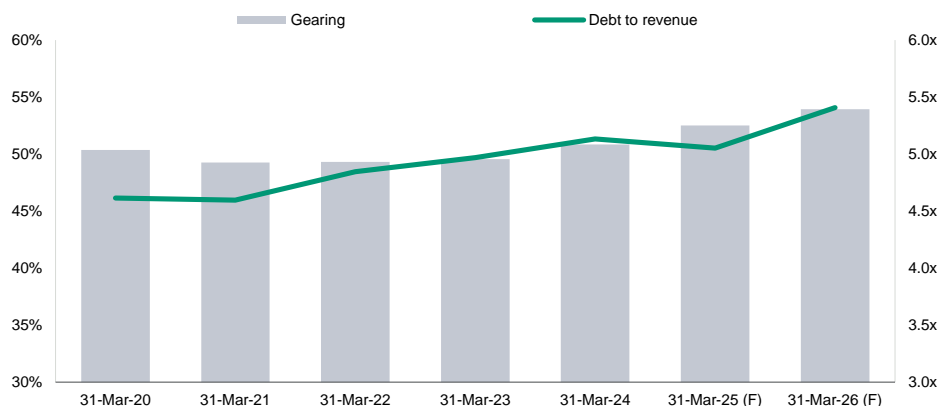
Update to credit analysis

Summary

The credit profile of [Sovereign Network Group](#) (SNG, A3 stable) reflects its large size, solid operating margins and good financial management. The ratings also incorporate its high indebtedness and large development programme. Sovereign benefits from the strong regulatory framework governing English housing associations and our assessment that there is a strong likelihood that the government of the [UK](#) (Aa3 stable) would act in a timely manner to prevent a default.

Exhibit 1

Higher leverage expected as SNG ramps up housing delivery
Gearing (LHS) and debt to revenue (RHS)



Prior to fiscal 2024, Sovereign Housing Association only.

Source: SNG and Moody's Ratings

Credit strengths

- » Large organisation with good financial performance
- » Supportive institutional framework in England

Credit challenges

- » High leverage to increase further
- » Substantial development ambitions with a moderate exposure to market sales

Rating outlook

The stable outlook reflects our expectation that the reduction in inflation and return to inflation-linked rent increases will support a gradual improvement in SNG's metrics.

Factors that could lead to an upgrade

Upward pressure on the ratings could result from a significant improvement in operating performance, a material reduction in debt or a significant increase in government support for the sector.

Factors that could lead to a downgrade

Downward pressure on the ratings could result from a prolonged weakening in operating performance and/or debt growing more quickly than forecasts. Lower government support for the sector or a dilution of the regulatory framework would also put to downward pressure on the ratings.

Key indicators

Exhibit 2

	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23	31-Mar-24	31-Mar-25 (F)	31-Mar-26 (F)
Units under management (no.)	59,517	60,355	61,023	62,026	84,586	86,211	86,622
Operating margin, before interest (%)	30.8	30.1	27.7	23.3	21.2	21.3	23.0
Net capital expenditure as % turnover	45.1	14.3	47.2	52.6	57.2	70.9	84.1
Social housing letting interest coverage (x times)	1.8	1.5	1.4	1.2	1.0	0.9	0.9
Cash flow volatility interest coverage (x times)	1.6	2.0	1.8	2.4	1.4	1.3	1.2
Debt to revenues (x times)	4.6	4.6	4.8	5.0	5.1	5.1	5.4
Debt to assets at cost (%)	50.4	49.3	49.3	49.5	50.9	52.5	53.9

Prior to fiscal 2024, Sovereign Housing Association only.

Source: SNG and Moody's Ratings

Detailed credit considerations

SNG's A3 ratings combine (1) a Baseline Credit Assessment (BCA) of baa2 and (2) a strong likelihood that the UK government would act in a timely manner to prevent a default.

Baseline credit assessment

Large organisation with good financial performance

Following the merger of Sovereign and Network Homes in 2023, SNG is among the largest housing associations in England managing over 84,000 units across London and the South West. Its sizeable balance sheet supports a higher capacity to absorb shocks than smaller housing associations and grants it robust market position, strong political influence and a competitive edge in development opportunities. As a member of the G15 organisation, SNG also collaborates with other large London-based housing associations to shape housing policy.

SNG's operating margin stood at 21% in fiscal 2024, which is in line with the median of A3-rated peers. Its margin declined in the last few years in line with the rest of the sector due to high cost inflation, a significant increase in spending on repairs and maintenance and government interventions on rent policy. We expect margins to recover from fiscal 2025 albeit more gradually than the rest of the sector. SNG will continue to incur costs related to the merger before net savings start to materialise from fiscal 2026. Moreover, SNG still faces fire safety remediation costs on its high-rises of £28 million annually on average over the next three years. We note that SNG has made more progress than most peers in addressing fire safety with over half of its remediation works having already been completed and the rest to be completed by fiscal 2026.

SNG's social housing lettings interest coverage (SHLIC) stood at 1.0x in fiscal 2024 in line with the median of A3-rated peers. SHLIC declined in line with the operating margin in recent years and was also negatively affected by the merger as Network had weak interest cover metrics. We expect SHLIC to remain around 0.9x over the next three years due to higher interest costs associated with SNG's planned increase in leverage. This is in contrast to rating peers for which SHLIC will gradually recover as most HAs have cut development spending to limit debt growth.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

Supportive institutional framework in England

The sector's credit quality benefits from the strong institutional framework governing English housing associations (HAs) reflected in an Operating Environment score of a3 and a Regulatory Framework score of a1. These scores are assigned at a national level and reflect the following credit considerations:

The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and regular programmed inspections for HAs with more than 1,000 units. The regulator has a strong track record of intervention in cases of mismanagement or financial stress.

The operating environment for English housing associations remains supportive. Demand for social housing is very high and English housing associations retain some expenditure flexibility, with a track record of controlling costs to mitigate lower income. The UK government confirmed that for fiscal 2026, rent increases within the English sector will be pegged at the September Consumer Price Index (CPI) plus 1%. The one-year extension of the rent settlement is positive, although it doesn't provide clarity for the medium-term.

High debt to revenues with strong additional borrowing capacity

SNG's debt metrics are weaker than peers. As of FYE 2024, its total outstanding debt was £3.6 billion, equivalent to 5.1x revenue (A3 peer median: 4.7x) and 51% of its assets (A3 peer median: 52%). We forecast that debt metrics will gradually deteriorate over the next five years, reflecting SNG's ambitious development programme and the need to invest in its existing stock, particularly for retrofitting. Debt may increase more than we currently forecast if SNG cannot fully execute planned disposals of assets, which are expected to fund around a quarter of its development expenditures.

Its debt structure is relatively low risk with 15% of drawn debt due for refinancing within the next five years and around 12% of its debt at variable rates. SNG has strong additional borrowing capacity with unencumbered assets of £2 billion as of June 2024, enough to cover the next five years of net funding needs. Its covenant headroom is sufficient with 90 basis points over its tightest interest cover covenant. SNG renegotiated and simplified its covenants as part of its merger to be based solely on EBITDA rather than EBITDA MRI, which strengthened its headroom.

SNG has decent liquidity with cash and undrawn facilities available within 48 hours of £854 million as end-June 2024. This is sufficient to cover 0.7x projected net funding requirement over the next two years, weaker than peers. We expect liquidity to remain adequate, supported by its golden rule to keep sufficient liquidity to cover over 18 months of net funding requirements excluding 25% of forecasted sales income.

Substantial development ambitions with a moderate exposure to market sales

SNG has an ambitious development plan with around 2,500 units to be delivered annually over the next five years, representing around 15% of its current stock. As a result, its net capital expenditure will remain much higher than peers at 66% of turnover on average over the next five years compared to 32% for the median of A3-rated peers.

Its development plan is split evenly between low-risk social housing lettings and market sales, including 38% of shared ownership units and 12% outright sales. Its appetite for market sales is higher than peers with a golden rule of a maximum of 35% of turnover. In fiscal 2024, sales accounted for 14% of its turnover, mostly first-tranche shared ownership, and are projected to increase to 19% driven by a higher exposure to outright sales.

The majority of its outright sales are delivered through joint ventures (JVs) with housebuilders or have already been sold to developers, mitigating some of the risks associated with outright sales. We also note that SNG has been able to maintain good sales margins of 17% on average over the past three years.

Extraordinary support considerations

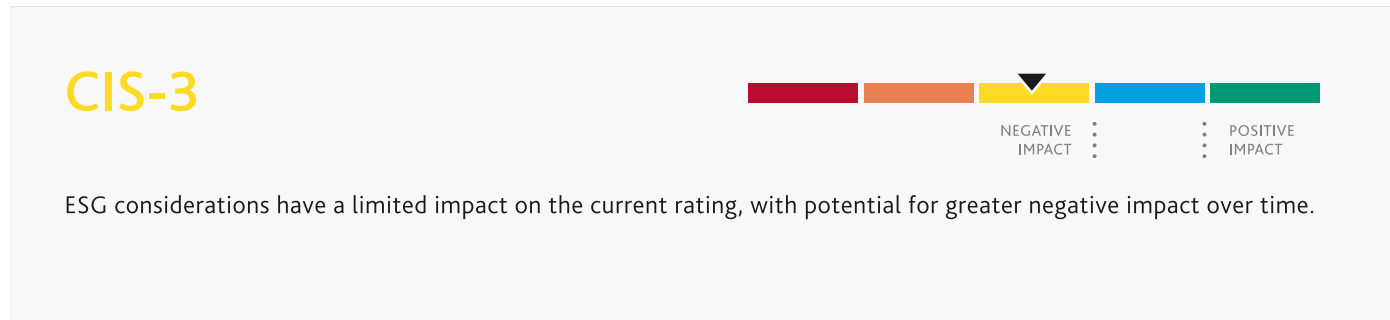
The strong level of extraordinary support factored into the rating reflects our view of the UK government's support for the housing association sector due to its political, economic and social importance. Extraordinary support for the sector is predominantly exercised through sector regulators whose wide-ranging powers in cases of financial distress include facilitating mergers. However, this process can be protracted and is reliant on HAs agreeing to merge, which is more challenging in a weakened operating environment, with high expenditure pressures and high borrowing costs. In addition, our assessment that there is a very high default dependence between SNG and the UK government reflects their strong financial and operational linkages.

ESG considerations

Sovereign Network Group's ESG credit impact score is CIS-3

Exhibit 3

ESG credit impact score



Source: Moody's Ratings

ESG risks have a material impact on SNG's ratings (**CIS-3**), mostly as a result of expenditure requirements related to carbon transition and fire safety.

Exhibit 4

ESG issuer profile scores



Source: Moody's Ratings

Environmental

SNG has some exposure to environmental risks (**E-3**), mostly carbon transition because over a quarter of its stock will need to be retrofitted to meet EPC-C by 2035, which will weigh on its margins.

Social

SNG has a material exposure to social risks (**S-4**) due to legal requirements to improve the safety of its existing stock and the vulnerability of the sector to tenant affordability considerations through the government's social rent policy. Those risks can materialise in the form of reduced operating margin and interest cover metrics.

Governance

SNG's governance is robust (**G-2**) with clearly identified policies and golden rules shaping its management of risk. Management and the Board are responsive to adverse events.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moody's.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned BCA of baa2 is in line with the scorecard-indicated BCA outcome in fiscal 2024.

For details about our rating approach, please refer to our [European Social Housing Providers](#) rating methodology, published in July 2024 and the [Government-Related Issuers](#) rating methodology published in January 2024.

Exhibit 5

Sovereign Network Group

Fiscal 2024

Baseline Credit Assessment	Sub-factor Weighting	Value	Score
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	84,586	aa
Factor 3: Financial Performance			
Operating Margin	5%	21.2%	baa
Social Housing Letting Interest Coverage	10%	1.0x	ba
Cash-Flow Volatility Interest Coverage	10%	1.4x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	5.1x	b
Debt to Assets	10%	50.9%	b
Liquidity Coverage	10%	0.7x	baa
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Scorecard - Indicated BCA Outcome			baa2
Assigned BCA			baa2

Source: SNG and Moody's Ratings

Ratings

Exhibit 6

Category	Moody's Rating
SOVEREIGN NETWORK GROUP	
Outlook	Stable
Baseline Credit Assessment	baa2
Issuer Rating	A3
SOVEREIGN HOUSING CAPITAL, PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Ratings

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