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Research Update:

Scotland-Based Registered Social Landlord Wheatley Housing Group Outlook Revised To Negative; Rating Affirmed At 'A+'

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Overview

- Ongoing uncertainty surrounding the U.K.'s exit from the EU and the lingering possibility of a hard Brexit means that we could expect economic pressure on the U.K. and its devolved regions.
- For Wheatley Housing Group (Wheatley), which has a close relationship with the Scottish government, any negative effects from Brexit could result in pressure on the regulatory environment in which it operates.
- We are therefore revising our outlook on Wheatley to negative from stable, and affirming our 'A+' issuer credit rating.
- The negative outlook is based on our view that Wheatley's operating and regulatory environment could come under pressure if the U.K.'s economy was to deteriorate as a result of its departure from the EU.

Rating Action

On May 18, 2018, S&P Global Ratings revised its outlook on Scotland-based registered social landlord Wheatley Housing Group (Wheatley) to negative from stable. We affirmed the long-term issuer credit rating at 'A+'.

At the same time, we affirmed our 'A+' issue rating on the £300 million bond issued by Wheatley Group Capital PLC, the group's wholly owned subsidiary.

Rationale

The outlook revision reflects the continued economic and political uncertainty surrounding the Brexit negotiations and the consequences it could have for Scotland's economy. As the biggest registered social landlord (RSL) in Scotland, Wheatley plays a very important role in helping the government to achieve its current housing target of 50,000 affordable homes by 2021. As a key delivery partner, Wheatley benefits from extensive capital grants that fund around 50% of the group's forecast capital expenditure. This means that it does not have to pursue market-related activities in order to subsidize funding, unlike its English peers. Wheatley also benefits from being able to set its own rents, which, combined with an increasing portfolio, is a leading factor behind its improving financial performance. Along with developing new homes, Wheatley also has a large capital maintenance program in which it is refurbishing stock it received from Glasgow Council in a large voluntary stock transfer in 2003, along with other properties in its portfolio. Therefore, although Wheatley receives substantial government grants, we still expect debt to increase modestly throughout our base case.

Wheatley's 'A+' rating is supported by its stand-alone credit profile (SACP), which we assess at 'a'. The SACP receives one notch of uplift from our opinion that there is a high likelihood that Wheatley would receive extraordinary support from the Scottish government, working through the Scottish Housing Regulator, in case of financial distress. We continue to view Wheatley's strategy and management as robust; management works closely with the Scottish Housing Regulator, meeting four times a year. The regulator views Wheatley as a systemically important RSL, as it believes that financial distress for Wheatley could cause difficulty for the regulator in fulfilling its statutory objective of protecting tenants. Wheatley lies in the regulator's "high" category of engagement based on its size of about 52,000 units, turnover, debt levels, and significance in its areas of operation.

Wheatley's expanding portfolio of social and midmarket homes stretches from Glasgow in the west of Scotland to Edinburgh in the east, with West Lothian and West Dunbartonshire also being key areas of activity. These areas continue to exhibit strong demand for Wheatley's services, as social housing is in higher demand in the U.K.'s devolved regions and the average social rent in Wheatley's areas of operation is still around 50% of market rent. Although we forecast Wheatley's social rents to increase in the coming years, we expect demand to remain resilient.

As part of the largest development plan of social housing in Scotland, Wheatley added 748 new homes to its portfolio in the financial year (FY) ending March 31, 2018 and plans to add a further 2,600 units by FY2021. Of the 2,600 units, around 75% will be social rent and the remainder will be midmarket rent. The development plan will be funded by private funding and government grants, with grants having increased recently for Wheatley by 25% in the west of Scotland and 20% in the east. Wheatley expects to receive around £135 million in government grants to contribute to its development program over this period.

Nevertheless, irrespective of government grants, we forecast debt to increase modestly through our base case to around £1.3 billion in FY2021 from £1.1 billion in FY2018. We forecast improved financial performance combined with modest debt growth to result in an average debt-to-EBITDA ratio of 13.3x for the same period. We understand Wheatley is in talks to contract a new European Investment Bank (EIB) facility of around £185 million in June 2018, which is expected to be a main funding source for its development plan, along with strong cash flow generated from operations. The increase in debt will see interest costs increase slightly, but we expect the EBITDA-to-interest ratio to remain sound at 1.5x throughout our base-case period.

We expect the addition of more units to Wheatley's portfolio, combined with flexibility in rent setting, to bolster its financial profile. Wheatley's reported financial performance indicates volatility in turnover and EBITDA margins, though the volatility stems from the government grants that Wheatley amortizes annually. However, on an intrinsic level with the amortized grants removed, Wheatley's financial performance continues to improve. Benefiting from the cost efficiencies that have been achieved through staff restructuring and demolitions that took place in FY2017, we forecast the group's financial performance to remain stable, with adjusted EBITDA margins forecast to increase to 35% in FY2021 from 32% in FY2018.

Liquidity

Wheatley's liquidity position has weakened slightly since last year, mainly as it reaches a peak point in its development plan. We currently do not include the EIB funding that management is expecting to agree imminently in our 12-month forward-looking calculation. Overall, we forecast liquidity sources to cover uses by 1.26x over this period.

Sources include:

- Adjusted EBITDA as a proxy for cash flow from operations of £90 million;
- Cash and liquid investments of £43 million;
- Undrawn facilities of £165 million; and
- Other receipts (government grants) of £60 million.

Uses include:

- Adjusted capital expenditure (net of capitalized repairs) of £224 million; and
- Interest and principal repayments of £60 million.

Outlook

The negative outlook is based on our view that Wheatley's operating and regulatory environment could come under pressure if the U.K.'s economy was to deteriorate as a result of its departure from the EU.

We could lower the rating on Wheatley over the next 24 months if signs of significant weakening of economic conditions in the U.K. and subsequently Scotland post-Brexit were to materialize, thereby affecting the ability to support the social housing sector.

We could revise the outlook to stable if we were to see uncertainties from Brexit subside, with Wheatley performing in line with our base case.

Table 1

Wheatley Housing Group Ltd. Key Statistics

	--Year Ended 31-Mar--				
(Mil. £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
Number of units owned or managed	51,494	51,823	52,613	53,674	54,116
Vacancy rates (% of rent net of identifiable service charge)	0.3%	0.3%	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)*	4.1%	4.0%	N.A.	N.A.	N.A.
Revenue§	262.4	260.5	270.2	283.1	295.4
Share of revenue from non-traditional activities (%)	19.7%	17.4%	16.7%	16.1%	18.4%
EBITDA¶	75.0	82.5	88.4	96.7	104.6
EBITDA/revenue (%)	28.6%	31.7%	32.7%	34.1%	35.4%
Interest expense	53.2	50.6	59.7	65.2	67.4

Table 1

Wheatley Housing Group Ltd. Key Statistics (cont.)

	--Year Ended 31-Mar--				
(Mil. £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
Debt/EBITDA (x)	13.3	13.3	14.0	13.3	12.7
EBITDA/Interest coverage† (x)	1.4	1.6	1.5	1.5	1.6
Capital expense	153.5	169.8	219.3	145.5	113.1
Debt	999.4	1094.7	1238.9	1287.1	1329.6
Housing properties (according to balance sheet valuation)	1598.8	1711.4	1872.3	1955.8	2003.4
Loan to value of properties (%)	62.5%	64.0%	66.2%	65.8%	66.4%
Cash and liquid assets	26.7	20.4	23.3	28.6	26.9

*Rent and service charge arrears. §Adjusted for grant amortization. ¶Adjusted for capitalized repairs. †Including capitalized interest. a--Actual e--Estimate bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available

Table 2

Wheatley Housing Group Ltd. Ratings Score Snapshot

Key Rating Factors	
Industry risk	2
Economic fundamentals and market dependencies	3
Strategy and management	2
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	3
Debt profile	4
Liquidity	3
Financial policies	2
Financial profile	3

S&P Global Ratings' analysis of social housing providers' creditworthiness rests on our scoring of eight key rating factors: (i) industry risk; (ii) economic fundamentals and market dependencies; (iii) strategy and management; (iv) asset quality; (v) financial performance; (vi) debt profile; (vii) liquidity; and (viii) financial policies. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published Dec. 17, 2014, and "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015, detail how we derive and combine the scores, and then determine each social housing provider's stand-alone credit profile and the issuer credit rating. In accordance with S&P Global Ratings' public and nonprofit social housing providers methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating, the committee can make use of the flexibility afforded by paragraphs 12-17 of "Methodology For Rating Public And Nonprofit Social Housing Providers."

Related Criteria And Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015

- Criteria - Governments - General: Methodology For Rating Public And Nonprofit Social Housing Providers - December 17, 2014
- General Criteria: Group Rating Methodology - November 19, 2013
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative - April 27, 2018
- Research Update: Northern Ireland-Based Apex Housing Association Affirmed At 'A'; Outlook Negative - November 29, 2017
- Research Update: Wales-Based Social Housing Association Pennaf Rating Affirmed At 'A'; Outlook Stable - May 09, 2018

Ratings List

	Rating	
	To	From
Wheatley Housing Group Ltd.		
Issuer Credit Rating		
Foreign and Local Currency	A+/Negative/--	A+/Stable/--
The Glasgow Housing Association Ltd.		
Issuer Credit Rating		
Foreign and Local Currency	A+/Negative/--	A+/Stable/--
Wheatley Group Capital PLC		
Senior Secured		
Local Currency	A+	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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.