

Research Update:

Scotland-Based Wheatley Housing Group Ltd. 'A+' Rating Affirmed; Outlook Remains Stable

May 23, 2022

Overview

- We forecast that Wheatley Housing Group's (Wheatley) focus on traditional activities and prudent cost management will help contain inflationary pressures and risks associated with increasing investment needs.
- We think the gradual improvement in EBITDA, combined with favorable cost of debt, will help the group maintain solid interest coverage.
- We affirmed our 'A+' long-term issuer credit ratings on Wheatley and its subsidiary, The Glasgow Housing Association Ltd. (Glasgow Housing). We also affirmed our 'A' long-term issuer credit rating on Lowther Homes Ltd., Wheatley's commercial arm. The outlook remains stable.

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Rating Action

On May 23, 2022, S&P Global Ratings affirmed its 'A+' long-term issuer credit ratings on Wheatley and core group entity Glasgow Housing.

At the same time, we affirmed our 'A+' issue rating on the £300 million bond issued by Wheatley Group Capital PLC, which we consider a core subsidiary of the group.

We also affirmed our 'A' long-term issuer credit rating on Lowther Homes. Lowther Homes is Wheatley's commercial arm, providing mid-market homes and property management services. The rating on Lowther is one notch lower than the rating on Wheatley, reflecting Lowther's status as a highly strategic entity within the group.

The outlooks on Wheatley, Glasgow Housing, and Lowther Homes remain stable.

Outlook

The stable outlook reflects our view that Wheatley's financial metrics will continue to have sufficient headroom to cope with challenges in relation to rising costs and increasing investment in existing stock.

Downside scenario

We could lower the rating on Wheatley if we saw a significant deterioration in the group's S&P Global Ratings-adjusted EBITDA margins due to higher costs than we currently anticipate over our base-case period. We could also lower the rating if the debt-funded spending on development increased materially beyond our projections and liquidity weakened on a sustained basis.

Upside scenario

We could raise the rating on Wheatley if management's efforts to control costs or additional grant funding resulted in EBITDA margins improving materially above our current projections, supporting a strengthening of the group's debt metrics.

We could also raise the rating if we thought Wheatley's role and link with the Scottish government had strengthened, implying a higher likelihood of extraordinary support.

Rationale

The rating affirmation reflects our view that the group's financial metrics will remain relatively resilient despite a weakening operating environment. The focus on core social housing activities, ability to raise rents on the expanding asset base, and the group's ability to prudently manage rising costs will gradually offset the risks associated with increasing investment needs. The improving margins, lower debt intake in comparison to our previous review, and interest cost savings will keep the debt build up at contained levels. We continue to assess Wheatley's liquidity coverage as very strong.

Wheatley, the largest housing association in Scotland, has an asset base of close to 65,000 units, of which more than 90% are for general needs rent. The group's geographical footprint stretches from the central belt of Scotland between Glasgow and Edinburgh to the south of Scotland near the English border. We think the group's relatively low general needs rent, which we estimate to be just under 60% of the Scotland's average market rent, reflects strong affordability levels supporting high demand for Wheatley's properties. This high demand is also demonstrated by vacancy rates of 1.1% on average over the past three years, which we estimate to be slightly below the sector's average.

Wheatley's strategy remains prudent and continues to focus on growing organically, with all development planned to include only affordable and mid-market homes. Although not classified as social tenure in Scotland, mid-market homes are a form of subsidized housing and rents remain lower than market rents. We also view favorably the efforts taken by management to generate operational efficiencies. These savings should help manage cost increases while allowing the group to keep rents for tenants at affordable levels. Furthermore, the group's strategy continues to place emphasis on achieving sustainability targets such as energy efficiency and carbon neutrality. These are also key metrics referenced in Wheatley's recently secured sustainability-linked facility.

We expect the growing asset base and the group's ability to raise rents will gradually offset cost and investment pressures, with margins improving to close to 30% by the end of our forecast horizon--the financial year ending March 31, 2025 (FY2025). For FY2022, we estimate the adjusted EBITDA margins deteriorated to about 21%. However, this drop in margins is temporary, stemming from a catchup on maintenance works following COVID-19 pandemic-induced delays suffered in FY2021 and increased spend to bring Dumfries & Galloway Housing Partnership's stock portfolio

up to regulatory standards during the year. Furthermore, the classification of all the group's stock improvement spends as operating in nature resulted in higher capitalized repairs and subsequently weaker margins in comparison to the previous reviews.

Wheatley continues to fund its development program with a mix of grant income and new debt intake. We expect the group to deliver close to 1,600 new homes over our forecast horizon, which represents a modest increase of close to 2% to the existing asset base after netting off planned demolitions. Despite an increase in nominal debt over our forecast horizon, we expect a gradual improvement in the debt to nonsales EBITDA to just under 15x and interest coverage of about 1.7x by the end of our base-case period. This improvement is supported by the group's debt restructuring and refinancing efforts over the past two years in combination with the expected recovery in EBITDA over our forecast horizon.

We assess the regulatory framework under which registered providers of social housing in Scotland operate as very strong because we consider that the Scottish Government places high priority on its social housing policies and agendas. We view oversight as being very strong in Scotland, and regulatory powers are extensive, including facilitating asset transfers and mergers for failing providers. We consider that ongoing support is strong, with high levels of grant funding for development in addition to the provision of welfare benefits to support rental income for tenants. We do not see any significant negative intervention, although the rollout of the decarbonization agenda across the U.K. could place additional financial and operational burdens on the Scottish social housing sector over the next few decades should additional grant funding not be made available.

We think Wheatley benefits from a high likelihood of timely and sufficient extraordinary support from the Scottish government, through the Scottish Housing Regulator, in the event of financial distress. We base our view of a high likelihood of extraordinary government support on our assessment of the group's very important role for the Scottish government and its public policy mandate, as well as its strong link with the Scottish government. This is demonstrated by the government's track record of providing strong credit support to the sector in certain circumstances. The regulator views Wheatley as a systemically important registered social landlord because it thinks financial distress for Wheatley could make it difficult for the regulator to fulfill its statutory objective of protecting tenants, since Wheatley remains a key delivery partner of the Scottish government's affordable housing program. Wheatley aims to contribute to about 11% of the government's housing target of delivering 110,000 affordable homes by 2032. This further illustrates that Wheatley lies in the regulator's high category of engagement, based on its large asset base, turnover, debt levels, and significance in its areas of operation.

Liquidity

We assess Wheatley's liquidity as very strong, underpinned by the group's comprehensive liquidity policy. We estimate sources of liquidity will cover uses by about 2.4x over the next 12 months. We continue to view Wheatley's access to external liquidity as satisfactory.

We expect sources of liquidity over the next 12 months will include:

- Cash flow from operations of about £92 million;
- Current cash and liquid investments of £71 million;
- Fixed asset sales receipts of about £1 million;
- Committed and undrawn facilities expiring beyond 12 months of about £286 million; and
- Grant receipt of just over £50 million.

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We expect uses of liquidity over the same period will include:

- Capital expenditure of just over £125 million; and
- Interest and principal repayments of about £81 million.

Key Statistics

Table 1

Wheatley Housing Group -- Key Statistics

Mil. £	--Year ended March. 31--				
	2021a	2022e	2023bc	2024bc	2025bc
Number of units owned or managed	64,132	64,442	64,681	64,665	65,307
Adjusted operating revenue	359.7	362.1	372.2	385.5	400.0
Adjusted EBITDA	99.3	74.5	91.2	105.0	118.1
Non-sales adjusted EBITDA	99.3	74.5	91.2	105.0	118.1
Capital expense	77.3	138.6	122.7	161.8	157.0
Debt	1,487.6	1,520.0	1,549.5	1,613.6	1,650.3
Interest expense	67.9	63.0	64.3	66.0	67.8
Adjusted EBITDA/Adjusted operating revenue (%)	27.6	20.6	24.5	27.2	29.5
Debt/Non-sales adjusted EBITDA (x)	15.0	20.4	17.0	15.4	14.0
Non-sales adjusted EBITDA/interest coverage(x)	1.5	1.2	1.4	1.6	1.7

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

Ratings Score Snapshot

Table 2

Wheatley Housing Group -- Ratings Score Snapshot

	Assessment
Enterprise risk profile	2
Industry risk	2
Regulatory framework	2
Market dependencies	2
Management and Governance	2
Financial risk profile	3
Financial performance	4
Debt profile	4
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 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 22, 2022
- U.K. Social Housing Sector Borrowing Needs To Rise To Fund Investment In New Homes, March 31, 2022
- Social Housing Outlook 2022: Green Agenda Takes Root In Investment Plans, Nov. 23, 2021
- How U.K. Public Finance Sectors Fare Under Latest Spending Review, Nov. 11, 2021
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings List

Ratings Affirmed

Wheatley Housing Group Ltd.

**Glasgow Housing Association Ltd.
(The)**

Issuer Credit Rating A+/Stable/--

Lowther Homes Limited

Issuer Credit Rating A/Stable/--

Wheatley Group Capital 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.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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

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