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Research Update:

Scotland-Based Registered Social Landlord Wheatley Housing Group 'A+' Rating Affirmed; Outlook Stable

May 25, 2023

Overview

- We forecast that Wheatley Housing Group Ltd.'s (Wheatley's) prudent management, focus on traditional activities, and expanding asset base will somewhat help counterbalance the cost pressures on the group's financial performance.
- We expect that a gradual recovery in S&P Global Ratings-adjusted nonsales EBITDA and a favorable cost of debt will help the group maintain relatively solid interest coverage.
- We therefore affirmed our 'A+' long-term issuer credit rating on Wheatley and its subsidiary, Wheatley Homes Glasgow (formerly known as The Glasgow Housing Association). We also affirmed our 'A' long term issuer credit rating to Lowther Homes Ltd., Wheatley's commercial arm. The outlooks remain stable.

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Rating Action

On May 25, 2023, S&P Global Ratings affirmed its 'A+' long-term issuer credit ratings on Wheatley Housing Group Ltd. (Wheatley) and core group entity Wheatley Homes Glasgow.

We also 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.

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

The outlooks on all group entities remain stable.

Outlook

The stable outlook reflects our view that strong demand for Wheatley's properties and prudent planning will somewhat offset the pressures associated with cost growth outpacing rent increases and increasing investment in existing and new assets.

Downside scenario

We could lower the rating if we see a material weakening of the group's financial metrics. This could happen if costs are significantly higher than we currently project or debt-funded spending on development increases materially beyond our projections, and liquidity sustainably weakens.

Upside scenario

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

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

Rationale

The rating affirmation reflects our view that Wheatley's management will prudently execute its business plan while keeping enough financial headroom to mitigate current operating challenges stemming from inflationary pressures, increasing investment needs in existing assets, and tightened funding conditions.

Enterprise profile: Robust management track record, no exposure to riskier market sale activities, and strong market position should continue to build resilience

Wheatley, the largest housing association in Scotland, has an asset base of close to 65,000 units, of which over 90% are for general needs rent. The group's geographical footprint stretches from the central belt of Scotland between Glasgow and Edinburgh to the southwest of Scotland down to the English border. We believe that Wheatley's relatively low general needs rent, which we estimate at close to 60% of Scotland's average market rent, reflects strong affordability levels, supporting high demand for Wheatley's properties. This is also evidenced by average vacancy rates of 1.2% over the past three years, which we estimate to be slightly below the sector average.

In our view, Wheatley's strategy remains prudent and it continues to focus on organic expansion, 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 with below-market rents.

In response to challenging market conditions and cost pressures, management pulled back on some discretionary investments. We believe this should help partly absorb cost pressures while allowing the group to keep rents affordable for tenants.

The group's strategy continues to place a strong emphasis on asset quality and achieving sustainability targets, such as energy efficiency and carbon neutrality. This is evidenced in more than 90% of its stock at Energy Performance Certificate (EPC) C standards (or higher).

Wheatley's development strategy remains aligned to its capabilities. After securing additional grants, the group is gradually expanding its development program to support the Scottish government's target. We expect Wheatley will deliver about 2,400 new homes over our forecast horizon--from the financial year ending March 31, 2024 (financial 2024) to financial 2026--which after netting off planned demolitions represents a modest 3% expansion of the asset base. On average, more than 50% of this program is uncommitted, providing additional flexibility to react to market conditions and limit capital expenditure (capex) when required.

We assess the regulatory framework under which registered providers of social housing in Scotland operate as very strong. This is because we consider that the Scottish government places high priority on its social housing policies and agendas (see "Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers," published June 8, 2021, on RatingsDirect).

Financial profile: An expanding asset base and cost-containment measures should mitigate pressure from inflation and investment requirements

We expect the group's adjusted EBITDA margins to remain comfortably above 20% over our forecast horizon, however the recovery will be slower than we projected in our previous base case. The weakening in financial 2023 was driven largely by cost inflation materially exceeding the increase in rents. In financial 2022, Wheatley had already suffered due to a catch-up effect on pandemic-related deferred maintenance works and the delivery of the delayed investment program required for the group's assets in Wheatley Homes South (formerly Dumfries & Galloway Housing Partnership), following the constitutional partnership agreed in December 2019.

Wheatley's development program remains funded through a mix of grant income and private finance. Despite an increase in nominal debt over our forecast horizon to fund investments, we expect debt metrics to gradually improve in line with the projected recovery in nonsales EBITDA. The group's active management of its debt portfolio, including past debt refinancing efforts, should support our expectation of a recovery in interest coverage. Wheatley also has access to the Scottish government's charitable bond program, administered by Allia, on which interest is to be repaid only on maturity. This reduces medium-term cash interest pressure for the group.

We view Wheatley's liquidity as very strong. Sources of liquidity are estimated to cover uses about 1.7x over the next 12 months. Although we anticipate a slight weakening in the liquidity coverage ratio, it should be temporary because we understand that the group plans to secure additional funding in the next few months.

At the same time, we believe Wheatley's access to external liquidity is satisfactory.

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

- Cash flow from operations of about £88 million;
- Current cash and liquid investments of close to £47 million;
- Fixed asset sales receipts of less than £1 million;
- Committed and undrawn facilities expiring beyond 12 months of about £260 million; and
- Grant receipts of just under £100 million.

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

- Capex, including development spending on homes for sale, of just over £206 million; and
- Interest and principal repayments of close to £83 million.

Government-related entity analysis

We think there is a high likelihood that the Scottish government would provide timely and sufficient extraordinary support to Wheatley, through the Scottish Housing Regulator, in the event of financial distress. We base our opinion 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. We think the regulator views Wheatley as a systemically important registered social landlord. This is because financial distress at 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 about 11% of the government's housing target of delivering 110,000 affordable homes by 2032. This further illustrates why 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.

Selected Indicators

Table 1

Wheatley Housing Group Ltd.--Key Statistics

	--Year ended March 31--				
Mil. £	**2022a**	**2023e**	**2024bc**	**2025bc**	**2026bc**
Number of units owned or managed	64,414	64,957	64,630	65,560	66,516
Adjusted operating revenue	381.5	361.1	377.3	392.0	411.2
Adjusted EBITDA	66.3	77.2	87.2	96.5	107.1
Nonsales adjusted EBITDA	66.3	77.2	87.2	96.5	107.1
Capital expense	141.1	127.4	208.4	184.1	181.1
Debt	1512.9	1555.1	1625.4	1712.7	1767.7
Interest expense	59.6	61.5	62.9	65.7	69.0
Adjusted EBITDA/Adjusted operating revenue (%)	17.4	21.4	23.1	24.6	26.1
Debt/Nonsales adjusted EBITDA (x)	22.8	20.1	18.6	17.7	16.5
Nonsales adjusted EBITDA/interest coverage(x)	1.1	1.3	1.4	1.5	1.6

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

Ratings Score Snapshot

Table 2

Wheatley Housing Group Ltd.--Ratings Score Snapshot

Enterprise risk profile	2
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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 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 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	
Wheatley Housing Group Ltd.	
Wheatley Homes Glasgow Ltd.	
Issuer Credit Rating	A+/Stable/--
Lowther Homes Limited	
Issuer Credit Rating	A/Stable/--
Wheatley Group Capital PLC	
Senior Secured	A+