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Research Update:

Scotland-Based Wheatley Housing Group Outlook Revised To Positive; 'AA-' Rating Affirmed

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Overview

- In our view, Wheatley Housing Group Ltd. (Wheatley), the parent of the Wheatley Group and a registered social landlord based in Scotland, is likely to cement its public policy role and improve its financial profile, through continuing as a key development partner of the Scottish government and successfully implementing its planned merger with Dunedin Canmore.
- We are therefore revising the outlook to positive from stable on Wheatley and on The Glasgow Housing Association Ltd., the main subsidiary within the group. We are affirming the 'AA-' ratings on both entities.
- The ratings reflect our assessment of Wheatley's 'bbb' category stand-alone credit profile; the extremely high likelihood that the Scottish government would provide extraordinary support if required; and Wheatley’s position among peers.

Rating Action

On June 4, 2015, Standard & Poor's Ratings Services revised to positive from stable the outlook on Wheatley Housing Group Ltd. (Wheatley), the parent of the Wheatley Group and a registered social landlord based in Scotland, and The Glasgow Housing Association Ltd (GHA), the main group subsidiary. We affirmed the long-term issuer credit ratings on both entities at 'AA-'.

At the same time, we affirmed our 'AA-' long-term issue rating on senior secured debt issued by Wheatley Group Capital PLC.

Rationale

The 'AA-' rating on Wheatley, the non-asset-holding parent of the Wheatley Group, is based on its 'bbb' category stand-alone credit profile (SACP), which we believe has strengthened in the past year; our opinion of the extremely high likelihood that the Scottish government would provide extraordinary support in the event of financial distress; and Wheatley's position among rated housing association peers.

The 'AA-' rating on GHA is equalized with that on Wheatley, reflecting GHA's status as a core entity within the group. GHA is the former parent of the group, and remains by far the largest member, owning 92% of the group assets and generating about 90% of group turnover. Reflecting this, we consider that there is also an "extremely high" likelihood that GHA would receive extraordinary support from the Scottish government.

Our current view of the Scottish government's creditworthiness reflects our view of the supportiveness of the institutional framework (the U.K. regional government system); the Scottish government's very low debt burden; its surpluses after capital accounts; and its limited, although improving, flexibility over revenues. We assess these rating factors according to our criteria, "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, on RatingsDirect. If Scotland were ever to become an independent sovereign, then these rating factors could well change significantly, and we would apply a different rating methodology, namely "Sovereign Rating Methodology," published on Dec. 23, 2014.

Our view of the extremely high likelihood of Wheatley receiving extraordinary government support reflects our assessment of:

- The critical importance to the Scottish government of Wheatley's role in operating and developing social housing; and
- The very strong link between the Scottish government and Wheatley.

Wheatley's role reflects its central and systemic importance within the Scottish social housing sector. Wheatley's social housing stock is four times larger than that of any other registered social landlord (RSL) in Scotland. If a proposed partnership with Edinburgh-based housing association Dunedin Canmore goes ahead, Wheatley could expect to have 51,000 social housing units (19% of the Scottish RSL sector).

Wheatley also plays a lead role in developing social housing, to the extent that the Scottish government describes it as "a key delivery partner." Furthermore, it plays a significant role in the local economy. Over the past 10 years, Wheatley estimates that it has created about 11,000 jobs, predominantly in Glasgow, Scotland's largest city, while delivering an investment program supported by government grants.

If Wheatley were to cease to exist, then transferring Wheatley's stock to other entities could present major challenges given that Wheatley has more units than the next-largest five RSLs together. In any case, a default by Wheatley could affect market access for other RSLs and government-related entities in other sectors. Therefore, if Wheatley were to require financial help, we think that the government would have very strong incentives to ensure help was provided, rather than face the negative implications of a default.

The Scottish government's very strong link with Wheatley is reflected in its influence over Wheatley's strategy and business plan. The government has recently allocated to Wheatley a development grant of about £180 million, and Wheatley's consequent development plans represent about 15% of the government's national target for social housing developed by RSLs. The government meets monthly with Wheatley to review progress on this development program, and on the refurbishment program that Wheatley committed to when GHA was created to receive a stock transfer from Glasgow City Council in 2003.

Wheatley is also monitored by the Scottish Housing Regulator. Because of its systemic importance in the Scottish housing sector, we consider that Wheatley benefits from a greater degree of regulatory scrutiny, and more frequent interaction, than its rated English peers do with the Homes and Communities Agency (HCA), the equivalent regulator in England. Like the HCA, the Scottish Housing Regulator has demonstrated a track record of intervening to support failing housing associations, whether through supervision, mergers, or arranging for additional grant.

Wheatley's SACP has strengthened within the 'bbb' category over the past year due to improved financial performance and a stronger liquidity position. The SACP continues to reflect Wheatley's very strong enterprise profile, with low industry risk; high demand for Wheatley's social housing; a business strategy that entails limited market risk; and good operational management. The SACP also reflects Wheatley's adequate financial profile. Although we view Wheatley's financial policies as sound, its EBITDA margins (adjusted for capitalized repairs net of relevant grant income) have been weak in the past relative to peers, leading to a high debt-to-EBITDA ratio. That said, we understand that EBITDA margins have risen strongly in the past year, and we believe that much of this will prove to be a structural improvement. The financial profile is also supported by a very strong liquidity position, which has improved over the past year following two bond issues.

Demand for Wheatley's social housing is robust, supported by the relative affordability of social housing rents at 52% of market rates (according to the Scottish Housing Regulator and CityLets), and partly demonstrated by very low voids at 0.8% of rental income in the financial year ending March 31, 2015 (financial 2015). Rent collection is also good, with social housing arrears (adjusted for technical arrears) at just 4.3% of rental income. Although there is some risk that arrears will rise with the introduction of universal credit, we believe at this stage that Scottish social housing tenants may be granted some flexibility over whether to receive the housing benefit component of universal credit directly. As such, we believe there will be a lower take-up of direct payments, reducing the potential impact on Wheatley's levels of arrears.

In terms of asset quality, Wheatley's stock has required significant investment in recent years, much of which has been grant-funded, to bring the stock up to the Scottish Housing Quality Standard. This has now been broadly achieved, with 98.5% of GHA stock now reaching the standard, up from about 90% a year ago.

With this achieved, Wheatley was able to reduce its spending on capital repairs in financial 2015, leading to an EBITDA margin (adjusted for capital repairs net of associated grant) of 24%, up from -2% in 2014. Looking ahead, we believe that much of this improvement will prove structural, and we expect that average EBITDA margins over the next three years will be in line with this, supported by a planned merger with Dunedin Canmore. Dunedin Canmore has higher EBITDA margins and is less indebted than Wheatley, so the merger should be noticeably positive for Wheatley's financial profile, assuming a successful integration. Wheatley's ability to raise rents above inflation is also likely to support an ongoing strengthening of its financial performance. Unlike its housing association peers in England, Wheatley is not limited to consumer price index (CPI) plus 1% annual rent increases.

Over our forecast horizon, Wheatley plans to take on substantial debt to fund its social (and affordable) housing development program of about 4,500 units, which will be partly funded by a development grant of about £180 million from the Scottish government. Despite this increase in debt, from £902 million at financial year-end

2015 to £1.31 billion by 2018, we believe that debt/EBITDA, our key measure of the affordability of debt, will actually reduce slightly from 15.1x to 13.9x, due to rising EBITDA in line with our above expectations.

Although Wheatley's business strategy does include significant development, we note that it is still conservative in relation to many English peers, in that its strategy remains focused on developing and operating social housing, with only limited exposure to commercial activities. This should support the predictability of its revenue and expenditure base.

Liquidity

We consider that Wheatley has a very strong liquidity position. Operating cash flows are generally predictable and, although holdings of cash are limited, the group has ready access to fully charged committed facilities to meet its cash flow needs. Its existing sources of liquidity exceed its currently expected uses over the next 12 months by 2.1x.

We view Wheatley's access to external liquidity as satisfactory. Although it has proven access to a number of banks, it is still establishing a track record of issuing on the capital markets.

Outlook

The positive outlook reflects the likelihood that we could raise the rating on Wheatley if it cements its critical public policy role through continuing as a key development partner with the Scottish government and successfully implementing its planned merger with Dunedin Canmore. We could also raise the rating on Wheatley if we revised upward our view of the creditworthiness of the Scottish government.

If there were signs of Wheatley's role becoming less important to the Scottish government, perhaps through a reduction in the size and scope of its activities, then we could revise the outlook back to stable. Alternatively, if we revised downward our view of the creditworthiness of the Scottish government, then this could lead to our revising the outlook to stable and potentially lowering the rating.

Wheatley Housing Group Ltd. Key Indicators and Financial Statistics

	--Year Ended March 31--						
(Mil. £)	**2012**	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**	**2018bc**
Number of units owned or managed	44,282	46,236	46,374	45,988	51,713	52,630	53,567
Voids/net rental income (%)	0.9	0.7	0.9	0.8	1.4	1.4	1.4
Arrears/net rental income (%)	5.9	4.8	4.4	4.3	4.3	5.0	5.3
Financial Performance							
Reported EBITDA/revenues (%)	17.9	13.6	11.8	28.8	37.2	42.1	47.7
Adjusted EBITDA (after capitalized repairs)/revenues	(18.5)	(6.8)	(2.0)	24.0	17.1	24.1	31.5

Wheatley Housing Group Ltd. Key Indicators and Financial Statistics (cont.)

	--Year Ended March 31--						
(Mil. £)	**2012**	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**	**2018bc**
(%)							
Debt Profile							
Debt/adjusted EBITDA (x)	(14.0)	(47.3)	(182.2)	15.1	23.2	17.6	13.9
Adjusted EBITDA/interest payable and capitalized interest (x)	(2.2)	(0.5)	(0.1)	1.8	0.9	1.2	1.4
Financial Statistics							
Income Statement (Mil. £)							
Turnover	194.7	193.3	195.4	249.0	276.3	287.7	300.6
Operating costs	(181.8)	(193.4)	(202.5)	(211.4)	(218.4)	(215.4)	(208.5)
of which depreciation	(21.9)	(26.4)	(30.1)	(34.0)	(44.8)	(48.9)	(51.3)
Operating surplus/(deficit)	12.8	(0.0)	(7.1)	37.6	57.9	72.3	92.1
Interest income	2.6	1.2	0.3	0.0	0.0	0.0	0.0
Interest payable	(16.6)	(24.3)	(26.5)	(33.1)	(50.6)	(55.9)	(65.8)
Net surplus (deficit) before tax	(19.4)	(21.0)	(3.1)	3.5	93.1	18.2	26.4
Cash Flow (Mil. £)							
Net cashflow from operations	34.2	18.4	33.7	40.1	68.4	76.9	106.9
Net interest	(16.6)	(24.3)	(26.5)	(48.6)	(51.4)	(57.2)	(65.0)
Net investing activities	(143.3)	(78.4)	(67.4)	(132.5)	(137.3)	(138.1)	(136.0)
Cash in/(out) before financing	(125.6)	(84.3)	(60.2)	(141.1)	(120.4)	(118.4)	(94.2)
Net cash flow from financing	122.3	86.4	79.4	189.2	75.3	118.6	94.5
Increase/(decrease in cash)	(3.4)	2.1	19.2	48.1	(45.1)	0.2	0.3
Balance Sheet (Mil. £)							
Housing properties	756.7	812.3	1107.6	1159.7	1533.0	1635.8	1734.9
Debt	504.3	623.1	713.1	902.3	1096.9	1216.1	1310.4
Cash and short-term investments	8.0	14.5	30.9	79.0	17.2	17.4	17.6

bc--Base case reflects Standard & Poor's expectation of the most likely scenario, which may differ from the entity's own forecasts.

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: Principles Of Credit Ratings - February 16, 2011

Related Research

- Wheatley Housing Group Ltd. - November 7, 2014

Ratings List

	Ratings	
	To	From
Wheatley Housing Group Ltd.		
Issuer credit rating		
Foreign and Local Currency	AA-/Positive/--	AA-/Stable/--
The Glasgow Housing Association Ltd.		
Issuer credit rating		
Foreign and Local Currency	AA-/Positive/--	AA-/Stable/--
Wheatley Group Capital PLC		
Senior Secured		
Local Currency	AA-	AA-

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