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Research Update:

Scotland-Based Wheatley Housing Group Upgraded To 'AA'; Outlook Stable

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Overview

- In our view, Wheatley Housing Group Ltd.'s expansion into strong markets for social housing cements its importance to the Scottish government and increases the likelihood of extraordinary support if required.
- Therefore, we are raising our long-term issuer credit rating on Scotland-based Wheatley Housing Group, the parent of Wheatley Group, to 'AA' from 'AA-'. At the same time, we are raising to 'AA' from 'AA-' the rating on The Glasgow Housing Association Ltd., the core subsidiary within the group.
- We are also raising to 'AA' from 'AA-' the existing senior secured debt rating on the £300 million bond issued in November 2014 by Wheatley Group Capital PLC, a wholly-owned subsidiary of Wheatley Housing Group Ltd.
- The ratings reflect our assessment of Wheatley's strong 'bbb' category stand-alone credit profile.
- The stable outlook reflects our view of Wheatley's strong enterprise profile.

Rating Action

On June 17, 2016, S&P Global Ratings raised to 'AA' from 'AA-' the long-term issuer credit ratings on Scotland-based Wheatley Housing Group Ltd. (Wheatley) and The Glasgow Housing Association Ltd. (GHA). The outlook on both entities is stable.

At the same time, we raised to 'AA' from 'AA-' our senior secured debt rating on the £300 million bond issuance from November 2014 by Wheatley Group Capital PLC, the group's wholly-owned subsidiary.

Rationale

The upgrade reflects our view of Wheatley's ongoing very strong link with the Scottish government, which, in our view, has been enhanced by the expansion of the group's operations into new areas of high demand for social housing. Following the recently concluded partnerships with Edinburgh-based housing associations Dunedin Canmore and Barony Housing Association (Barony), Wheatley is estimated to have just over 50,600 social housing units (19% of the Scottish registered social landlord sector). The Scottish government describes it as "a key delivery partner", with Wheatley set to deliver about one-fifth of the government's plan of building 50,000 affordable homes over the next five years. Therefore, given its size and its increased geographic base, if Wheatley were to require financial help, we believe that the government would have a very strong incentive to ensure help was provided, rather than face the negative implications of a default.

The 'AA' rating on Wheatley, the non-asset-holding parent of Wheatley Group, continues to be based on its strong 'bbb' category stand-alone credit profile (SACP), which we believe will strengthen further over our forecast horizon, albeit

from a low base. The rating also reflects 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.

Our view of the extremely high likelihood of Wheatley receiving extraordinary government support reflects our assessment of its critical importance to the Scottish government's delivery of the social housing development policy, and the very strong link between the two. The Scottish Housing Regulator has once again affirmed Wheatley's systematic importance and has identified its level of engagement as "high" in its latest report.

Wheatley's financial performance remained stable in FY2016, with adjusted EBITDA of 21% of operating revenues. Core surplus after stripping out gains from the business combinations with Dunedin Canmore and Barony was also stable at 3%. Over our forecast horizon, we expect Wheatley's financial performance to strengthen as it seeks to achieve cost efficiencies of up to 13% per unit of stock, partially supported by the end of the demolition program of old stock (around 3% of operating expenditure in FY2016). Meanwhile, we project that core rental income will grow by about 9% due to the positive impact of Dunedin Canmore and Barony on the group's performance, as well as a predictable rise in rental income. We also factor the volatility observed over the forecast horizon into our assessment of Wheatley's financial performance.

Wheatley's current development pipeline is 2,400 housing units, of which 60% will be social, as part of its long-term development program. This would bring its completion to about 47% of its total delivery plan of 7,426 homes as part of its long-term investment program, by the end of our forecast horizon. Approximately one-fifth of it is supported by government grants, which means that debt stock will continue to grow on an absolute level, reaching £1.3 billion by FY2019 and averaging 17x EBITDA (adjusted for capitalized repairs) over the forecast horizon, which we consider very high compared with peers.

Liquidity

We consider that Wheatley has a strong liquidity position, with sources of cash exceeding uses by about 1.3x over the next 12 months. This coverage is supported by about £220 million in committed undrawn bank facilities as well as £44 million in cash. The group's strong coverage is further buttressed by a more supportive regulatory and policy environment in Scotland for social housing providers than that experienced by peers in England, who have been forced to apply rent cuts of 1%. By contrast, in Scotland there is no cap on chargeable rents.

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

Outlook

The stable outlook reflects our view of Wheatley's strong enterprise profile reflected in the high demand for social housing in its area of operations over the next two years. This is counterbalanced by Wheatley's improving but still weaker financial profile than English peers, attributed to GHA's nature as a large-scale voluntary transfer.

We consider a positive rating action as highly unlikely over our forecast horizon. On a stand-alone basis, this would imply a much faster-than-expected improvement in Wheatley's financial performance, which would likely lead to higher liquidity and a substantial reduction in the debt burden. Alternatively, we could upgrade Wheatley if we were to revise upward our assessment of the creditworthiness of the Scottish government.

We could lower the rating on Wheatley if, on a stand-alone basis, we were to observe either a sharp deterioration in the financial performance over our forecast horizon, a permanent return to a negative net margin territory resulting from unsuccessful implementation of the cost savings program, or an unsuccessful integration of Dunedin Canmore and Barony within the group. In such a scenario, we would likely observe a faster-than-expected rise in debt levels and a deteriorating liquidity position. This would prompt us to revise downward our assessment of management. Alternatively, we could also lower the rating on Wheatley if we were to revise downward our assessment of the Scottish government.

Wheatley Housing Group Ltd. Selected Financial Indicators

(Mil. £)	2015a	2016e	2017bc	2018bc	2019bc
Number of units	50,645	51,115	52,016	52,918	52,918
Vacancy rates (% of net rental income)	0.7	0.7	1.4	1.4	1.4
Arrears (% of net rental income)*	4.3	3.4	5.5	5.8	6.1
Revenue	252,183	271,828	276,195	305,212	315,767
Development for sale/revenue (%)	N.A.	N.A.	N.A.	N.A.	N.A.
Share of revenue from non-traditional activities (%)	14.5	15.0	16.0	15.0	15.0
Operating expense	215,553	219,319	237,209	229,154	226,427
EBITDA§	80,406	108,306	98,766	137,421	153,518
EBITDA/revenue (%)	32.0	40.0	36.0	45.0	49.0
Interest expense	35.5	47.3	56.2	62.2	64.8
Debt/EBITDA (x)	14.5	17.2	25.2	13.8	12.4
EBITDA/interest coverage (x)†	1.50	1.17	0.75	1.40	1.62
Capital expense	132,514	142,455	195,292	172,236	123,880
Debt	759,974	987,369	1,102,344	1,243,726	1,343,560
Housing properties (according to balance-sheet valuation)	1,176,864	1,579,722	1,735,551	1,842,699	1,913,969
Loan to value of properties (%)	65.0	63.0	63.5	67.5	70.2
Cash and liquid assets	101,996	50,933	16,819	52,737	95,224

*Current arrears. §Adjusted for capitalized repairs. †Including capitalized interest.

a--Actual. e--Estimate. N.A.--Not available. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

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: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

Ratings List

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

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