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Research Update:

Scotland-Based Wheatley Housing Group Outlook Revised To Stable On Stronger Financial Performance, 'A+' Rating Affirmed

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Overview

- Wheatley Housing Group's (Wheatley) financial performance has improved over the last couple of years, and we forecast that revenues and profitability will keep strengthening over the next two to three years. We have revised our assessment of Wheatley's stand-alone credit profile (SACP) to 'a' from the 'bbb' category.
- We have revised our view of the likelihood of extraordinary support from the Scottish government should Wheatley find itself in financial distress to high from extremely high because we think that the government's ability and willingness to provide extraordinary support has diminished since Wheatley has passed the initial stage of consolidation of the transferred housing stock from Glasgow City Council.
- We have therefore revised our outlook to stable from negative and affirmed our 'A+' issuer credit ratings on Wheatley and its core subsidiary Glasgow Housing Association (GHA).
- The stable outlook reflects our view that Wheatley's financial profile is likely to continue to improve, underpinned by stronger and more stable S&P Global Ratings-adjusted revenues, EBITDA, and EBITDA margins, mitigating potential pressure stemming from continued institutional and economic uncertainty surrounding the Brexit negotiations.

Rating Action

On May 26, 2017, S&P Global Ratings revised its outlook to stable from negative on Scotland-based Wheatley Housing Group (Wheatley) and its core subsidiary The Glasgow Housing Association Ltd. (GHA). We affirmed the 'A+' long-term issuer credit ratings.

At the same time, we affirmed our 'A+' issue rating on the £300 million bond issued by Wheatley Group Capital PLC, Wheatley's financing subsidiary that we consider as core entity within the group.

Rationale

The outlook revision reflects our view that Wheatley's stand-alone credit profile (SACP) is likely to continue to improve, underpinned by stronger and more stable S&P Global Ratings-adjusted revenues and EBITDA margins, mitigating potential pressure stemming from continued institutional and economic uncertainty surrounding the Brexit negotiations. In our view, Wheatley's financial risk profile has strengthened and we project that its adjusted EBITDA margins will continue to improve and remain at 30%-35% through March 2019, and potentially strengthen to more than 40% in fiscal year to March 31, 2020, compared with less than 25% in the fiscal year ending March 31, 2016.

The rating affirmation reflects the combination of Wheatley's improving SACP and a weakening of the probability of extraordinary support from the Scottish government. In our view, Wheatley's SACP has strengthened to 'a' from the 'bbb' category, underpinned by its very strong enterprise profile and improving financial performance, evidenced by S&P Global Ratings-adjusted EBITDA margins exceeding 30% through the forecast period.

We also think that the ability and willingness to provide extraordinary support has diminished since Wheatley has passed the initial stage of consolidation of the transferred housing stock from Glasgow City Council, and its SACP is strengthening. We now assess the likelihood of extraordinary support from the Scottish government, working through the Scottish Housing Regulator, as high rather than extremely high. We continue to think that Wheatley is very important to the government and supports its focus on the social housing sector, underpinned by Wheatley being five times larger than its nearest peer in Scotland.

In our view, Wheatley remains a very important partner in implementing the government's housing policy, which includes an additional 50,000 homes in Scotland over the current parliamentary period through April 2021, of which 35,000 would be for social rent and the remainder different types of housing within the affordable segment. We think that Wheatley has a strong link with government and the regulatory authorities, evidenced by continuous oversight and reporting requirements. However, we have revised the likelihood of support because we understand that financial support from the Scottish government would likely be provided through additional grant funding supporting Wheatley's development of social housing assets, rather than through any extraordinary financial support.

The regulator has intervened numerous times in recent years when a registered social landlord (RSL) has encountered governance issues or been in financial distress, but we note that there is neither a formal legal framework nor guarantees provided for these RSLs. However, we consider as supportive for the RSLs that the regulatory authorities take statutory actions or intervene to appoint governing body members or managers so as to protect tenants' interests as well as public and private funders' confidence and the reputation of RSLs.

We consider that the social housing industry exhibits low risk globally given low cyclicality, continuous high demand, and solid ongoing government support. More specifically, we see strong demand for social housing in Scotland. Social rent of about £76 a week in Wheatley's main area of Glasgow, for instance, is more than 50% lower than the average market rent in the area, continuing to support demand for Wheatley's housing assets despite relatively low population growth of about 0.3% annually. Furthermore, Wheatley's low exposure to market related development for sales activities contributes to high quality of earnings, in our opinion. Social and affordable housing rent in Scotland, which contribute about 90% to Wheatley's revenues, are not subject to the same rent cuts imposed on the Registered Providers of Social Housing operating under the English regulatory framework. Wheatley can set its own rents, and our base case does indeed include a steady increase, in line with or above inflation.

We assess Wheatley's strategy and management positively. It has a highly experienced senior management team that focuses on consistently meeting targets set within the traditional social housing sector. We also factor into our assessment of Wheatley's enterprise profile the high quality of its housing assets, given a portfolio of more than 50,000 units (with an average age of about 55 years) and very low vacancy rates, with lost revenues due to voids amounting to about 0.7% of net rental income as of March 2017.

In our view, Wheatley's financial risk profile has strengthened and we project that it will continue to do so over the next two to three years. We forecast that reported revenues will steadily increase by about 3%-5% annually, following a slight decline in the fiscal year to March 31, 2017, to £270 million from more than £280 million in the prior year, due to the demolishing of depleted housing assets in the Glasgow area. We also project that its S&P Global Ratings-adjusted EBITDA margins will continue to strengthen and remain at 30%-35% through March 2019, and potentially strengthen to more than 40% in fiscal year to March 31, 2020, compared with less than 25% in the fiscal year ending March 31, 2016.

We project only a modest increase of Wheatley's debt each year, of about £100 million, as internal cash flow generation remains strong, resulting in average adjusted debt to EBITDA of less than 15x through the forecast period to March 2020. EBITDA interest coverage during the same period average 1.3x. Scottish RSLs receive more development grants than the Housing Associations in England so, under our base case, Wheatley's leverage remains relatively moderate despite a substantial development program. Our base case is that Wheatley will spend on average £150 million annually on developing and maintaining housing, with about a fifth of that funded by the government via grants. Wheatley, via its core subsidiary GHA, is part way through a program to develop 2,800 units for social and mid-market rent in 2014-2021, a majority of which would be for social housing. In addition to grant funding and internally generated cash flow, Wheatley is funding the development with debt, including a £300 million bond issued in 2014, syndicated bank facilities and other bilateral loan agreements, and funding from the European Investment Bank.

Liquidity

We assess Wheatley's liquidity as strong, reflecting our opinion that sources of liquidity will cover uses by 1.5x over the next 12 months and that Wheatley has satisfactory access to external liquidity.

Sources of liquidity include available cash of more than £50 million and undrawn committed bank facilities totaling £160 million; forecasted operating cash flow (before interest payments) of more than £90 million; and grants from the government in support of its development of affordable housing.

Main uses of liquidity include capital spending of more than £180 million and interest payments of close to £60 million.

Outlook

The stable outlook reflects our view that Wheatley's SACP is likely to continue to improve, underpinned by stronger and more stable S&P Global Ratings-adjusted revenues and EBITDA margins, mitigating potential pressure stemming from continued institutional and economic uncertainty surrounding the Brexit negotiations.

We could lower the ratings over the next 24 months should Wheatley's financial performance not improve, evidenced by adjusted EBITDA margins falling below 30%, volatile earnings, or a worsening liquidity position. A lower rating could also result from us revising further downward the likelihood of support from the Scottish government. We consider this unlikely over the next two years. Downside rating pressure could also build if there is a significant weakening of economic fundamentals or the regulatory framework under which Wheatley operates.

An upgrade would likely depend on a combination of a significantly stronger SACP and a satisfactory resolution of the continued institutional and economic uncertainty surrounding the Brexit negotiations.

Wheatley Housing Group Ltd. Selected Financial Indicators

Year Ended	**March 31**				
Balance Sheet Date Year	2016a	2017e	2018bc	2019bc	2020bc
('000 £)					
Number of units	50,731	51,030	51,482	52,553	53,450
Vacancy rates (% of net rental income)	0.7	0.7	1.5	1.5	1.5
Arrears (% of net rental income)*	2.4	0.7	0.7	0.8	0.7
Revenue§	248,003	238,439	249,874	230,803	255,038
Share of revenue from non-traditional activities (%)	18.0	10.2	10.4	10.3	10.2
Operating expense (before D&A)	190,486	166,394	163,329	155,702	148,365
EBITDA¶	57,517	72,045	86,545	75,101	106,673
EBITDA/revenue (%)	23.2	30.2	34.6	32.5	41.8
Interest expense	48,379	54,765	61,248	67,703	72,370
Debt/EBITDA (x)	16.4	14.1	13.5	16.9	12.8
EBITDA/interest coverage (x)†	1.2	1.3	1.4	1.1	1.5
Capital expense¶	136,392	149,606	170,125	164,760	134,916
Debt	941,778	1,019,146	1,169,396	1,269,628	1,369,879
Housing properties (according to balance sheet valuation)	1,604,950	1,706,267	1,812,758	1,913,903	1,980,421
Loan to value of properties (%)	59	60	65	66	69
Cash and liquid assets	61,691.0	22,169.0	87,246.0	107,515.0	154,936.0

*Current 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

Related Criteria

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

Ratings List

	Rating	
	To	From
Wheatley Housing Group Ltd.		
Issuer Credit Rating		
Foreign and Local Currency	A+/Stable/--	A+/Negative/--
The Glasgow Housing Association Ltd.		
Issuer Credit Rating		
Foreign and Local Currency	A+/Stable/--	A+/Negative/--
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.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site 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.