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Research Update:

Scotland-Based Wheatley Housing Group Assigned 'AA-' Rating; Bond Rated 'AA-'; Outlook Stable

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Overview

- Wheatley Housing Group Ltd. (Wheatley) plays a central and systemically important role in the Scottish social housing sector, with social housing stock four times larger than any other registered social landlord (RSL) in Scotland.
- We are assigning our 'AA-' long-term issuer credit rating to Wheatley, the parent of the Wheatley Group, and our 'AA-' rating to The Glasgow Housing Association Ltd., the main subsidiary within the group.
- We are also assigning a senior secured debt rating of 'AA-' to a proposed bond issuance from Wheatley Group Capital PLC, a wholly-owned subsidiary of Wheatley Housing Group Ltd.
- The stable outlook balances our view that the extremely high likelihood of government support for Wheatley will continue, as will the strong demand for its social housing, against its weak but improving financial performance as Wheatley continues its investment program.

Rating Action

On Nov. 7, 2014, Standard & Poor's Ratings Services assigned its 'AA-' long-term issuer credit ratings to Wheatley Housing Group Ltd. (Wheatley) and to its subsidiary The Glasgow Housing Association Ltd. (GHA). The outlook on both entities is stable.

At the same time, we assigned our 'AA-' senior secured issue rating to a proposed bond issuance from Wheatley Group Capital PLC.

Rationale

The 'AA-' rating on Wheatley Group Capital's (the issuer's) proposed bond is linked to the rating on the GHA, to whom the issuer will onlend the majority of the proceeds via group borrower, Wheatley Funding No. 1 Ltd. Part of the proceeds will also be onlent, via the group borrower, to other registered social landlords that are part of the Wheatley Group. The GHA will guarantee all the group borrower's payments to the issuer. Consequently, any change in the rating on GHA will trigger a change in the bond rating. Wheatley Group Capital is a financing vehicle that is a wholly-owned subsidiary of Wheatley.

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); 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 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. 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 Government Rating Methodology and Assumptions," published on June 24, 2013."

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 such 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 over 11,000 jobs, predominantly in Glasgow, Scotland's largest city, while delivering an investment program supported by government grant.

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 allocated to Wheatley about £180 million of development grant over the next seven years. 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 is supported by its very strong enterprise profile, reflecting 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) are very weak relative to peers, leading to a very high debt-to-EBITDA ratio. That said, we do forecast some improvement in this respect. Liquidity is currently strong, and will become stronger following the planned bond issuance.

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 0.9% of rental income in the financial year ending March 31, 2014 (financial 2014). That said, significant ongoing investment is needed to bring the stock up to the Scottish Housing Quality Standard. Consequently, Wheatley is set to post relatively modest adjusted EBITDA margins, averaging 14.5% of turnover in financials 2015 and 2016. We understand that management aims to achieve 100% compliance with the Scottish Housing Quality Standard by 2015 and that spending on maintenance and repairs should then reduce. We are therefore forecasting a structural improvement in EBITDA, with EBITDA margins rising to 22% in financial 2017, and continuing to rise gradually thereafter.

At the same time, Wheatley plans to take on substantial debt to fund its social (and affordable) housing development program of 4,505 units, which will be partly funded by about £180 million of development grant from the Scottish government. Given the demand for social housing, and Wheatley's potential flexibility to adjust rents (where it has greater freedom than its English peers) or its expenditure profile, we assume in our base-case scenario that this should be broadly achievable within Wheatley's planned financial parameters. Wheatley's business strategy remains focused on social housing--it

anticipates having only limited exposure to commercial activities. This should support the predictability of its revenue and expenditure base.

Liquidity

We consider that Wheatley has a 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 about 1.25x.

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

Outlook

The stable outlook balances our view that the extremely high likelihood of government support for Wheatley will continue, as will the strong demand for its social housing, against Wheatley's weak but improving financial performance as it continues its investment program.

We could lower the ratings if Wheatley's role were to become less important to the Scottish government, resulting in a diminished likelihood of its receiving extraordinary support. Alternatively, if we revised downward our view of the Scottish government's creditworthiness, then this could cause us to lower the rating on Wheatley. A weakening of Wheatley's SACP, if this were by several notches, could also lead us to lower the ratings.

We could raise the ratings on Wheatley if we revised upward our view of the creditworthiness of the Scottish government, or of the likelihood of its providing extraordinary support.

Related Criteria And Research

Related Criteria

- Public And Nonprofit Social Housing Providers: Methodology And Assumptions , July 11, 2012
- Group Rating Methodology, Nov. 19, 2013
- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance, Sept. 13, 2013
- Guarantee Criteria--Structured Finance, May 7, 2013

Related Research

- Wheatley Housing Group Ltd., Nov. 7, 2014

Ratings List

New Rating; CreditWatch/Outlook Action

Wheatley Housing Group Ltd.

The Glasgow Housing Association Ltd.

Issuer Credit Rating AA-/Stable/--

New Rating

Wheatley Group Capital PLC

Senior Secured AA-

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