

Research Update:

U.K.-Based The Wrekin Housing Group 'A' Rating Affirmed; Removed From Under Criteria Observation; Outlook Stable

August 20, 2021

Overview

- U.K. social housing provider The Wrekin Housing Group Ltd. (Wrekin) operates stock in areas where there is strong demand for its properties, benefits from very strong liquidity, and has no exposure to development-for-sale activities.
- We expect the group's development of affordable and social housing will support future EBITDA growth but keep debt high, while interest coverage will remain solid following the group's refinancing.
- We affirmed our 'A' long-term issuer credit rating on Wrekin and removed it from under criteria observation (UCO). The outlook remains stable.

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Rating Action

On Aug. 20, 2021, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on Wrekin. The outlook is stable. We also removed the rating from UCO, where we placed it following the implementation of our updated criteria for social housing providers on June 1, 2021.

At the same time, we affirmed our 'A' issue rating on Wrekin's £250 million senior secured bond.

Outlook

The stable outlook reflects our view that Wrekin's margins will remain solid, supported by the group's rental development ambitions, and that management will successfully manage the group's increasing debt burden.

Downside scenario

We could lower the rating on Wrekin if management deviated substantially from their current

strategy. Under this scenario, we would see the group's investments in existing and new stock putting greater pressure on performance and liquidity than we currently envision.

We could also lower the rating if we considered Wrekin had become less likely to receive extraordinary government support through the Regulator of Social Housing (RSH).

Upside scenario

We could raise the ratings on Wrekin if they improved operational efficiencies such that vacancy rates stood significantly below market levels. We could raise the ratings on Wrekin if over the medium term if an increase in investment in existing stock is counterbalanced through rent increases or cost cutting, leading to an strengthening in EBITDA margins to stand structurally above 30%.

Rationale

Supporting the rating affirmation is our view that Wrekin benefits from a highly predictable revenue stream from core rental activities, which represent close to 90% of the group's revenue. Following the refinancing, despite the group's increasing debt position, Wrekin maintains a very strong liquidity position, underpinned by the group's large undrawn facilities, and solid interest coverage. We expect the group's profitability to remain predictable over the forecast period, supported by its development ambitions and rent regime allowing rents to rise up to 1% above the consumer price index (CPI), which will counterbalance increasing investments in existing stock.

We believe there is a moderately high likelihood that Wrekin would receive timely extraordinary government related support in case of financial distress. This provides one notch of uplift from the stand-alone credit profile (SACP). As one of the key goals of the RSH is to maintain lender confidence and low funding costs across the sector, we believe it is likely that the RSH would step in to try and prevent a default in the sector. We base this view on the RSH's record of mediating mergers or arranging liquidity support from other registered providers in cases of financial distress, and think this would also apply to Wrekin.

The group benefits from strong demand for its properties, although it operates across the West Midlands, where economic fundamentals are less dynamic than in other U.K. regions. Social rents in this region average 65% of market rents, compared with 41% of market rent in London. Despite a temporary increase in voids in the group's supported operations due to the pandemic, we expect demand for the group's services will remain high and Wrekin's vacancy rates will remain low and in line with the sector average.

We assess the regulatory framework under which registered providers of social housing in England operate as strong, underpinned by their public policy mandate to provide affordable homes. We also consider that the sector benefits from solid ongoing oversight by the RSH. These strengths are partly offset in our view by the relatively low levels of grant funding that housing providers in England receive for the development of affordable homes. Providers in England can develop homes for outright sale, using the proceeds as an alternative funding source, but we think that this exposes them to risks and potential volatility compared with providers in other regions. Providers in England are also subject to negative intervention from the U.K. government in the form of constraints on rent setting or additional spending responsibilities, without adequate additional funding.

Wrekin remains on track to deliver its development plan, targeting the completion of around 2,400 units over the next five years, in line with last year's plan. We expect that all of the group's

development will be for social and affordable tenures, supported by its successful refinancing and the group's asset renewal plan. We note that Wrekin's management has extensive experience in the social housing sector, and we take a positive view of the group's development strategy, which we consider conservative and aligned with its capabilities. Following the refinancing, the group lowered its cost of debt, released additional security headroom, and implemented more robust treasury and financial policies to support their strategy.

Additional borrowings to fund the group's development ambitions will further constrain our debt assessment. Following the group's refinancing, its debt burden has increased considerably, and we expect debt to EBITDA will remain on average above 20x across our forecast period of financial year (FY) 2022 to FY2024. This is counterbalanced by the group's strong interest coverage, as Wrekin has achieved significant interest cost savings due to a lower interest rate and longer average debt life. We expect EBITDA interest coverage to remain strong at above 1.5x over the forecast period.

We anticipate that financial performance will be affected across FY2022 to FY2024 as the group increases its investments in existing stock, with margins dropping below 30%. The group's care operations also weigh on profitability. We forecast that margins will strengthen toward the end of FY2024, supported by the group's development activities as well as the rent settlement allowing social rents to increase 1% above the CPI.

Liquidity

We now view Wrekin's liquidity position as very strong. Following the refinancing, liquidity is a rating strength for Wrekin. Over the next 12 months, we estimate that Wrekin's sources of liquidity will cover its uses by 2x. We believe Wrekin has satisfactory access to the debt capital markets.

Sources of liquidity include:

- Cash flow from operations of about £24 million;
- Cash balances of £30 million;
- Undrawn committed bank lines of about £102 million;
- Asset sales of close to £11 million; and
- Grant income and other cash inflows totalling around £30 million.

Uses of liquidity include:

- Capex and development spend of close to £85 million; and
- Interest and principal repayments of about £16 million.

Key Statistics

Table 1

Wrekin Housing Group Ltd.--Key Statistics

Mil. £	--Year ended March 31st--				
	2020a	2021e	2022bc	2023bc	2024bc
Number of units owned or managed	13,608	13,689	14,025	14,577	14,965
Adjusted operating revenue	86.0	88.8	88.0	94.5	99.5

Table 1

Wrekin Housing Group Ltd.--Key Statistics (cont.)

Mil. £	--Year ended March 31st--				
	2020a	2021e	2022bc	2023bc	2024bc
Adjusted EBITDA	24.6	26.9	22.2	26.7	29.2
Non-sales adjusted EBITDA	23.9	26.4	22.2	26.7	29.2
Capital expense	45.7	53.5	82.7	86.9	51.4
Debt	528.4	492.2	532.2	590.4	592.7
Interest expense	13.7	13.6	15.1	16.5	17.8
Adjusted EBITDA/Adjusted operating revenue (%)	28.6	30.3	25.2	28.2	29.3
Debt/Non-sales adjusted EBITDA (x)	22.1	18.7	24.0	22.2	20.3
Non-sales adjusted EBITDA/interest coverage(x)	1.7	1.9	1.5	1.6	1.6

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

Ratings Score Snapshot

Table 2

Wrekin Housing Group Ltd.--Ratings Score Snapshot

	Assessment
Enterprise risk profile	2
Industry risk	2
Regulatory framework	3
Market dependencies	3
Management and Governance	2
Financial risk profile	4
Financial performance	4
Debt profile	5
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

- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, June 1, 2021
- 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

- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 23, 2021
- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021
- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Outlook 2021: Strong Liquidity Should Help Social Housing Providers Remain Resilient, Dec. 8, 2020
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020

Ratings List

Ratings Affirmed

Wrekin Housing Group Ltd.

Issuer Credit Rating A/Stable/--

Senior Secured 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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website 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.

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