Research Update:

U.K.-Based Wrekin Housing Group Ltd. 'A' Ratings Affirmed; Outlook Stable

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Overview

- We expect that Wrekin Housing Group Ltd.'s strategy to reshape its care services will lessen the pressure from cost inflation and increasing investment in existing stock.
- Although rising interest rates will weigh on Wrekin's interest cover, we forecast that a gradual strengthening of S&P Global Ratings-adjusted non-sales EBITDA, supported by the continued delivery of new units, will somewhat mitigate the impact.
- We also anticipate that Wrekin's actions to delay some development spending will contain debt buildup.
- We therefore affirmed our 'A' long-term issuer credit rating on Wrekin. The outlook is stable.

Rating Action

On Aug. 17, 2023, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on Wrekin Housing Group Ltd. The outlook is stable. 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 the risks associated with inflationary pressures on costs, rising interest rates, and Wrekin's need to invest in its existing and new stock are mitigated by the group's focus on traditional rental activities and robust management.

Downside scenario

We could lower the rating on Wrekin if management deviated substantially from its current strategic and financial direction. This could materialize if we thought management failed to take timely cost-control actions, including its plan to address the losses from its high-level care facilities, or increased debt-funded spending on development more than we currently envision.

Upside scenario

We could raise the ratings on Wrekin if management successfully contained the risks associated with the cost pressures and development, such that the adjusted EBITDA margin improves faster than we currently forecast. We would also expect management's efforts to yield improvements in the group's debt metrics.

Rationale

Enterprise profile: Supported by a strong focus on traditional social housing lettings and timely mitigation of financial pressure

Wrekin remains strongly focused on its core rental businesses. We understand that most of the new units in the development pipeline are allocated for general needs and supported housing units. This underpins our view that the group will continue to generate most of its earnings in the predictable and countercyclical social housing sector. We project that the exposure to shared-ownership sales will remain limited at about 2% of S&P Global Ratings-adjusted revenue on average over the next two to three years.

In our view, the demand for Wrekin's properties remains strong. This is despite the group's operations across Shropshire and Staffordshire in the West Midlands, where the economic fundamentals are less dynamic than in other U.K. regions. We estimate that the group's social rent is about 64% of the market rent, which supports the demand for its properties. We note that vacancy rates will improve because the disposal of a care facility that has carried high void losses is close to completion. We expect the vacancy rates will stay near 1.1% of rent and service charge receivables, on par with the sector average after the disposal.

We think Wrekin has appropriate strategic planning in investing in existing and new homes. With 81% of its properties at EPC C, or above, level, the cost of its energy efficiency improvements should be lower than for peers. Also, we do not expect significant fire safety risk since the majority of the buildings are low-rise. Although we forecast that the maintenance costs of the existing properties will steadily increase, we believe the group has flexibility to reprofile these costs if needed. At the same time, we view positively that the group will exercise its flexibility in its development targets by delivering new units over a longer period to ease the financial pressure.

We assess as strong the regulatory framework under which registered providers of social housing in England operate (see "Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers," published June 8, 2021, on RatingsDirect).

Financial profile: Anticipated rent increases and improving margins in the care business will underpin a gradual recovery of Wrekin's financial metrics

We forecast that Wrekin's financial performance will remain solid, with a five-year-average adjusted EBITDA margin at about 26%, despite the inflationary pressure on the cost base and rising investment in the existing stock. We assume that the group can increase its rents, which will slightly outpace the cost inflation in the coming two to three years, with some of its supported housing units being exempt from the government cap in fiscal 2024. Additionally, we expect that the recent sale of a high-level care facility should enable the group to continue to slowly improve its care services, which are still loss making currently. We project that a strengthening of the adjusted non-sales EBITDA, on the back of additional rental units from the ongoing development program. This, in our view, will soften the pressure on debt metrics, enabling them to strengthen gradually over the coming two to three years.

We expect that rising interest expense from the group's variable rate debts will constrain adjusted non-sales EBITDA interest cover. Nevertheless, management's decision to delay some of its development spending, alongside the increasing adjusted non-sales EBITDA, will likely somewhat mitigate the impact. As a result, we forecast that the debt intake will be slower than our previous expectations. We also believe the group will advance its asset disposal program despite the softening property market. The proceeds from the disposal of uneconomical units is an important source of funding for its the development program, alongside grant income and new borrowing.

We view Wrekin's liquidity position as strong. Over the next 12 months, we expect the ratio of liquidity sources to uses will be about 1.5x. We forecast liquidity sources include about £146 million in cash, undrawn and available credit facilities, asset sales, grant receipts, and cash from operations (adding back the noncash cost of sales). This will cover liquidity uses of about £99 million, mainly for capital expenditure and debt service payments. We continue to assess Wrekin's access to external liquidity as satisfactory.

Government-related entity analysis

We believe there is a moderately high likelihood that Wrekin would receive timely extraordinary support from the U.K. government, through the Regulator of Social Housing (RSH), in case of financial distress. This provides a one-notch uplift from the stand-alone credit profile. Given that one of the key goals of the RSH is to maintain lender confidence and low funding costs, we believe the regulator is likely to intervene to help sector players, including Wrekin, avoid a default. We base our view on previous records of the RSH mediating mergers or arranging liquidity support from other registered providers in cases of financial distress and think this would also apply to Wrekin.

Selected Indicators

Table 1

Wrekin Housing Group Ltd.--Key Statistics

	--Year ends March 31--				
Mil. £	**2022a**	**2023e**	**2024bc**	**2025bc**	**2026bc**
Number of units owned or managed	13,744	13,879	14,084	14,433	14,616
Adjusted operating revenue	89.8	94.1	96.3	103.7	109.1
Adjusted EBITDA	23.9	21.5	23.8	28.7	30.9
Non-sales adjusted EBITDA	23.4	20.3	23.5	28.4	30.6
Capital expense	58.5	73.0	84.5	61.4	25.0
Debt	504.8	523.0	554.0	593.0	592.2
Interest expense	13.3	16.3	23.5	24.2	23.4
Adjusted EBITDA/Adjusted operating revenue (%)	26.6	22.8	24.8	27.6	28.3
Debt/Non-sales adjusted EBITDA (x)	21.6	25.7	23.6	20.9	19.4
Non-sales adjusted EBITDA/interest coverage(x)	1.8	1.2	1.0	1.2	1.3

a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

Wrekin Housing Group Ltd.--Ratings Score Snapshot

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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

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- United Kingdom Outlook Revised To Stable From Negative On Moderating Fiscal Risks; 'AA/A-1+' Ratings Affirmed; April 21, 2023
- U.K. Social Housing Borrowing 2023: On Pause, March 28, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2023, March 27, 2022
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2023, March 27, 2022
- Non-U.S. Social Housing Providers Ratings History: March 2023, March 27, 2023
- U.K. Social Housing Providers Set Their Sights On Cyber Risks, Dec. 16, 2022
- Non-U.S. Social Housing Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022

- Inflation To Erode The Performance Of U.K. Public Finance Sectors, Nov. 29, 2022
- Cap On Rent Increases Is Consistent With Our Base Case For English Social Housing Providers, Nov. 17, 2022
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 2022
- Launch Of Rent Cap Consultation Adds Uncertainty To Creditworthiness Across English Housing Sector, Sept. 1, 2022
- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings List

Ratings Affirmed	
Wrekin Housing Group Ltd.	
Issuer Credit Rating	A/Stable/--
Senior Secured	A