

Research Update:

# Wales-Based ClwydAlyn Housing Ltd. 'A' Rating Affirmed; Outlook Stable

July 14, 2022

## Overview

- Social housing provider ClwydAlyn Housing Ltd. (ClwydAlyn) continues to benefit from its focus on developing rental units and related generous grant funding from the Welsh government.
- Although higher costs weigh on ClwydAlyn's debt metrics, depressing its S&P Global Ratings-adjusted EBITDA, we expect that the increase in rental units and annual rent uplift should prevent further weakening.
- We affirmed our 'A' long-term issuer credit rating on ClwydAlyn.
- The outlook is stable.

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## Rating Action

On July 14, 2022, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on ClwydAlyn. The outlook is stable.

At the same time, we affirmed our 'A' issue rating on the £250 million bond issued by PenArian Housing Finance PLC. PenArian Housing was set up for the sole purpose of issuing bonds and lending the proceeds to the group, and we view it as a core subsidiary of ClwydAlyn.

## Outlook

The stable outlook reflects our view that ClwydAlyn's solid and increasing rental revenue will mitigate the impact of the higher cost of maintaining its properties. We project that gradually improving adjusted non-sales EBITDA will support stable debt metrics, despite rising debt levels.

## Downside scenario

We could lower the rating on ClwydAlyn if its financial performance deteriorated more than we currently expect, for example through higher inflation and investment in existing homes. Pressure on the rating could also arise from the group taking on more debt than we currently anticipate to

fund its increasing development spend. In our view, these scenarios could weigh on the group's performance and sustainably weaken interest coverage toward 1x. The rating could also be pressured if we changed our view on the likelihood of the Welsh government providing extraordinary support in case of need.

## **Upside scenario**

We could upgrade ClwydAlyn if its adjusted EBITDA improves materially, or its debt funding needs reduces, for example due to more than expected grant funding for investment in existing or new homes. In our view, this could strengthen the group's debt profile and liquidity position.

## **Rationale**

The affirmation reflects that ClwydAlyn will continue to demonstrate stable financial performance. This is underpinned by the group's continued focus on traditional social housing activities and the supportive Welsh policy framework, which benefits the group with favourable grant funding. We expect the adjusted EBITDA margin to be pressured as the cost base will increase faster than the rent increases during the fiscal year ending March 31, 2023 (fiscal 2023), due to rising inflation. We assume the rent increases in the following years and the positive effect of rental revenue from new units will partly offset the difference. We forecast that the margin will still be lower than our previous base case, with a five-year average of about 21%, compared with about 25%.

We expect the Welsh government's grant funding to limit ClwydAlyn's future debt intake, although its metrics will weaken. Throughout our forecast period, we anticipate that the grant will substantially cover about 50% of the development spend, moderately increasing the total debt in our forecast period. That said, we forecast that the weaker non-sales adjusted EBITDA will weigh on the group's debt metrics, with debt to non-sales adjusted EBITDA remaining above 20x in the coming two-to-three years. We understand that ClwydAlyn aims to complete a relatively large number of units in the coming two-to-three years following delays during the pandemic. Given the inflationary pressure and other operational challenges in the sector, we understand that the group intends to scale back on development thereafter, which would reduce its funding requirements. In our view, the group has ample flexibility to adjust its development spend, of which at least about 50% is uncommitted from fiscal 2024.

We think that demand for the group's social housing properties will remain relatively strong--despite tighter social and affordable rent, which we estimate at about 70% of the market rent--compared with English peers. The pandemic depressed the group's operational metrics because of the difficulties in carrying out maintenance works on empty properties and filling care home voids. This has temporarily increased vacancy rates but we estimate that these have gone down in the past fiscal year. Overall, the group's vacancy rates on average over the past three years was 2.5% of rent and service charge receivable, which is broadly in line with around 2% that we estimated for the Welsh housing sector.

In our view, management has sufficient expertise to run the various segments of operations. We think the group will continue to focus on traditional social housing lettings in North Wales, mainly general needs and supported housing, with exposure to sales remaining negligible. We expect the group will keep investing in its existing homes to comply with required standards in areas such as fire safety and decarbonization. Currently, 63% of the group's stock has attained an energy performance certificate rating of 'C' or above.

We think there is a high likelihood ClwydAlyn would receive extraordinary government-related support in case of financial distress. This provides a two-notch uplift from ClwydAlyn's stand-alone

credit profile. This is based on our opinion of the Welsh government's capacity to support public sector enterprises, and on our view that ClwydAlyn plays an important role for the Welsh government in social housing provision. We also consider that ClwydAlyn has a very strong link to the Welsh government because the government directly regulates the social housing sector, thus providing strong regulatory oversight.

We assess the regulatory framework under which registered providers of social housing in Wales operate as very strong, underpinned by the Welsh government's high priority on its social housing agenda. The Welsh social housing sector represents nearly a fifth of the total housing market, and as such, is a vital public service. In line with the U.K.-wide push for decarbonization, Wales is strongly focused on sustainability and carbon reduction. We understand the government provides solid support in the form of grant funding for this purpose. We view oversight in Wales as solid, with the regulatory function forming a part of the government itself, residing within the housing regulation team. The Welsh market is considerably smaller than those in England and Scotland, which allows for greater engagement between the regulator and providers but could also suggest less regulatory capacity than larger markets. Supportiveness for the sector is stronger in Wales than in England. The sector's primary financial support mechanisms are higher levels of grant funding for eligible development (about 40%-50% of costs), specific additional grants for energy-efficient homes, and the provision of welfare benefits to support rental income for providers.

## **Liquidity**

We view ClwydAlyn's liquidity position as strong based on our forecast that over the next 12 months, sources of liquidity will cover uses by 1.7x. We assess ClwydAlyn's access to external liquidity as satisfactory.

Liquidity sources include:

- Cash of more than £25 million;
- Cash flow from operations of nearly £10 million;
- The undrawn, available portion of committed bank facilities maturing beyond the next 12 months, totaling nearly £35 million;
- Proceeds from fixed-asset sales of nearly £2 million; and
- Proceeds from grant receipts of nearly £45 million.

Liquidity uses include:

- Capital expenditure exceeding £60 million; and
- Interest payment and debt repayment of nearly £9 million.

## **Key Statistics**

Table 1

**ClwydAlyn Housing Ltd.--Key Statistics**

Mil. £	--Year ended March 31--				
	2021a	2022e	2023bc	2024bc	2025bc
Number of units owned or managed	6,240	6,313	6,369	6,747	7,063
Adjusted operating revenue	46.3	47.3	49.4	52.9	56.8
Adjusted EBITDA	13.1	9.8	8.9	9.7	11.4
Non-sales adjusted EBITDA	13.1	9.8	8.9	9.7	11.4
Capital expense	21.9	35.0	60.8	72.4	35.8
Debt	224.2	235.5	235.0	274.4	276.8
Interest expense	7.5	7.9	8.1	8.7	9.4
Adjusted EBITDA/adjusted operating revenue (%)	28.2	20.6	18.1	18.4	20.1
Debt/non-sales adjusted EBITDA (x)	17.2	24.1	26.3	28.2	24.2
Non-sales adjusted EBITDA/interest coverage(x)	1.8	1.2	1.1	1.1	1.2

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

**ClwydAlyn Housing Ltd.--Ratings Score Snapshot**

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

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

## Research Update: Wales-Based ClwydAlyn Housing Ltd. 'A' Rating Affirmed; Outlook Stable

- General Criteria: Group Rating Methodology, July 1, 2019
- 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 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 22, 2022
- U.K. Social Housing Sector Borrowing Needs To Rise To Fund Investment In New Homes, March 31, 2022
- Social Housing Outlook 2022: Green Agenda Takes Root In Investment Plans, Nov. 23, 2021
- How U.K. Public Finance Sectors Fare Under Latest Spending Review, Nov. 11, 2021
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

## Ratings List

### Ratings Affirmed

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#### ClwydAlyn Housing Ltd

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Issuer Credit Rating A/Stable/--

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#### PenArian Housing Finance PLC

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Senior Secured A

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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](http://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](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](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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; or Stockholm (46) 8-440-5914

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