

Research Update:

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

July 19, 2021

## Overview

- Wales-based social housing provider ClwydAlyn Housing Ltd. (ClwydAlyn) benefits from operating in a low-risk industry and a favorable regulatory environment involving grant funding from the Welsh government, which has also supported the group's financial performance during the COVID-19 pandemic.
- High levels of debt and weak market dependencies in its areas of operation constrain our rating on ClwydAlyn, although we view positively the group's solid interest coverage and strong liquidity.
- We affirmed our 'A' long-term issuer credit rating on ClwydAlyn.
- The stable outlook is based on our view that the group's predictable and growing revenue base will support a continuous strengthening of financial performance.

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## Rating Action

On July 19, 2021, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on ClwydAlyn Housing Ltd. (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, a core subsidiary of ClwydAlyn.

## Outlook

The stable outlook is based on our view that ClwydAlyn's predictable revenue base and planned developments will support continuous strengthening of financial performance, improving the group's debt to EBITDA to structurally below 20x.

## Downside scenario

We could lower the rating on ClwydAlyn if its financial performance deteriorated as a result of

significant increases in its cost base to achieve energy efficiency targets. Under this scenario, we would also expect the liquidity position to deteriorate. We could also downgrade ClwydAlyn if we were to change our view on the likelihood of the Welsh government providing extraordinary support in case of need.

## **Upside scenario**

We could raise our rating on ClwydAlyn should its debt to EBITDA decline faster than we anticipate as a result of EBITDA margins recovering faster than we currently expect. We could also raise our rating if management continued to build a track record of consistent strategy, leading our assessment of management to improve, all else being equal.

## **Rationale**

The affirmation reflects the resilience that ClwydAlyn has demonstrated throughout the pandemic, with its operating margin remaining solid, above 25%. This is underpinned by the group's focus on traditional social housing activities, as well as the supportive policy framework from which it benefits, with a generous grant environment and a flexible rental regime. We forecast that this regime, combined with the group's aim to expand its asset base, will support an improvement in financial performance through our forecast until the financial year ending March 31, 2024 (FY2024). We expect S&P Global Ratings-adjusted EBITDA margins to trend toward 26% by FY2024. Development for traditional social tenures will expand ClwydAlyn's predictable revenue-generating asset base. In addition, ClwydAlyn can increase social rents in line with consumer price index (CPI) inflation +1% from FY2020. Improving margins will support a lower debt-to-EBITDA ratio going forward if ClwydAlyn does not increase debt more than we currently forecast. However, ClwydAlyn's existing debt position is still high compared with peers', which, combined with weak market dependencies in its areas of operations, continues to constrain the rating.

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.

ClwydAlyn faces less favorable market dependencies than most U.K. peers, with one the lowest discounts between social and market rents in our portfolio. This puts the group at risk of competing with private landlords. The group owns and manages more than 6,200 properties for social and affordable housing, with a geographical focus on North Wales. Introduced in 2020, a five-year rent settlement allows social housing providers in Wales to increase rents by CPI inflation +1% over this period. This will continue to raise social rents and narrow the gap between social and market rents.

The pandemic led to a worsening in operational metrics, but we expect an increase in voids linked to care homes will be temporary and that vacancies will decline to historical levels of below 2%. Support from local authorities toward voids, combined with the group's low dependence on self-paying tenants, protects its income levels. We forecast only a small, temporary reduction in rent collected in FY2022 due to the ending of the furlough scheme, which will slightly hamper profitability during the year. Less than one-third of total income comes directly from residents,

with 69% coming from different government sources and subsidies--local authorities, housing benefits, Universal Credit, and housing grants.

We expect ClwydAlyn will continue to focus on the delivery of its development plan, which it will fund with a combination of substantial capital grants from the Welsh government, internal cash-flow generation, and a small increase in borrowings. We view the group's development ambitions as aligned to management's capabilities, with ClwydAlyn's management having significant experience in the social housing sector. The group aims to deliver 1,500 units by 2023, focusing on traditional tenures--mainly social rent and supported housing. The group has completed more than 660 units so far, and we expect it will deliver the remaining units over the next two years. Government grants are likely to subsidize about 50% of the cost of the planned completions.

We expect significant grants toward the group's development plan will lead to low levels of additional borrowings needed over the forecast period. Historically, ClwydAlyn has operated a revenue grant system, which required the group to raise debt in anticipation of receiving revenue grants, raising the group's leverage higher than most rated peers'. We expect it will now service a proportion of this debt with grants from the Welsh government. Following the pandemic, we expect debt to EBITDA to improve and trend toward 18x, supported by the group's predictable and increasing performance. We forecast that adjusted EBITDA interest coverage will remain very solid, averaging 1.5x over the forecast period.

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 has a strong focus on sustainability and carbon reduction, which we view as highly influential in the social housing market. 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 size of the market in Wales is considerably smaller than in England and Scotland, which allows for greater engagement between the regulator and providers but could also suggest less regulatory capacity when compared with 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 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, in line with our previous base case. We forecast sources of liquidity to cover uses by 1.35x, supported largely by undrawn facilities and government grants.

We expect liquidity sources over the next 12 months will comprise:

- Our forecast of cash generated from continuing operations of £12.2 million;
- Cash and liquid investments of £25.3 million;
- Proceeds from asset sales of £0.9 million;
- The undrawn, available portion of committed bank facilities or bank lines maturing beyond the next 12 months of £35.3 million; and
- Receipts from deferred private placement of £11 million; and

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- Ongoing cash injections of £21.9 million from the government.

We expect uses of liquidity over the same period will include:

- Capital expenditure of £67.5 million; and
- Interest and principal payments of £11.6 million.

We continue to view ClwydAlyn's access to external liquidity as satisfactory.

## Key Statistics

Table 1

### ClwydAlyn Housing Ltd. -- Key Statistics

(Mil. £)	--Year ended March 31--				
	2020a	2021e	2022bc	2023bc	2024bc
Number of units owned or managed	6,048	6,135	6,236	6,710	6,912
Adjusted operating revenue	44.44	46.61	47.94	50.65	54.35
Adjusted EBITDA	10.36	11.96	11.96	12.76	14.35
Non-sales adjusted EBITDA	10.36	11.96	11.96	12.76	14.35
Capital expense	24.06	30.00	76.34	49.85	44.13
Debt	204.77	223.73	251.87	253.34	262.34
Interest expense	7.41	7.71	8.24	8.52	8.63
Adjusted EBITDA/Adjusted operating revenue (%)	23.31	25.66	24.95	25.20	26.41
Debt/Non-sales adjusted EBITDA (x)	19.77	18.71	21.06	19.85	18.28
Non-sales adjusted EBITDA/interest coverage(x)	1.40	1.55	1.45	1.50	1.66

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

## Ratings Score Snapshot

Table 2

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

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	4
Liquidity	3

Table 2

## ClwydAlyn Housing Ltd. -- Ratings Score Snapshot (cont.)

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: 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

- 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

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#### ClwydAlyn Housing Ltd

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Issuer Credit Rating A/Stable/--

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**Ratings Affirmed**

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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/sourceld/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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