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CREDIT OPINION
16 February 2023

Update

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RATINGS

Walsall Housing Group Ltd

Domicile	United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Walsall Housing Group Ltd (UK)

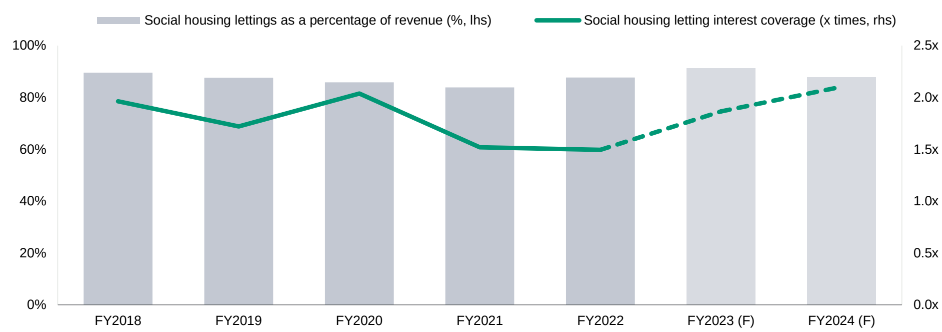
Update to credit analysis

Summary

The credit profile of Walsall Housing Group Ltd (whg, A3 stable) reflects its low-risk business model focused on social housing lettings and strong operating performance, as well as its relatively high gearing and its moderate development ambitions. The sector benefits from the strong regulatory framework governing English housing associations and our assessment of a strong likelihood that the government of the United Kingdom (UK, Aa3 negative) would intervene in the event that whg faced acute liquidity stress.

Exhibit 1

Social housing lettings (SHL) remain high as a proportion of revenues, which underpins the strong social housing lettings interest coverage (SHLIC)



F: Forecast.
Source: whg and Moody's Investors Service

Credit Strengths

- » Solid operating performance and strong interest coverage ratios
- » Strong financial management and sustained concentration on low-risk SHL
- » Supportive institutional framework in England

Credit Challenges

- » Increased capital spending due to moderate development ambitions and increased investment in stock
- » Relatively high gearing, mitigated by substantial liquidity

Rating Outlook

The stable outlook reflects our expectation that whg will continue to strengthen its balance sheet whilst maintaining interest coverage ratios at a stronger level than peers, despite the exposure to weakening economic conditions in the UK. This is driven by Walsall's strong financial management, moderate exposure to market sales and moderate development ambitions.

Factors that Could Lead to an Upgrade

Positive pressure could result from a marked improvement in debt metrics, with a maintained good operating performance despite meeting the nationwide retrofitting ambitions.

Factors that Could Lead to a Downgrade

Negative pressures could arise as a result of one or a combination of the following: a weakening in financial performance metrics, including interest coverage ratios at levels close to or below 1x; a ramp-up in risk appetite, including higher exposure to market sales than the moderate level currently projected; or an increase in indebtedness, including gearing sustained at levels above 60%. In addition, a weaker regulatory framework or dilution of overall support from the UK government for the sector could also exert negative pressure on the ratings.

Key Indicators

Exhibit 2

Walsall Housing Group

	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23 (F)	31-Mar-24 (F)
Units under management (no.)	20,644	21,065	21,364	21,619	21,933	22,012	22,529
Operating margin, before interest (%)	35.4	29.1	25.5	27.4	26.6	23.3	28.3
Net capital expenditure as % turnover	15.6	22.2	34.1	15.5	7.6	53.0	40.6
Social housing letting interest coverage (x times)	2.0	1.7	2.0	1.5	1.5	1.9	2.1
Cash flow volatility interest coverage (x times)	2.2	2.3	2.9	2.2	2.4	2.6	3.1
Debt to revenues (x times)	3.8	3.7	3.9	3.2	3.8	3.0	3.0
Debt to assets at cost (%)	67.3	63.2	61.6	55.2	49.2	50.8	52.2

F: Forecast.
Source: whg, Moody's Investors Service

Detailed Credit Considerations

The credit profile of whg, as expressed in an A3 stable rating, combines (1) a baseline credit assessment (BCA) of baa1 and (2) a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline Credit Assessment

Solid operating performance and strong interest coverage ratios

Whg's operating margin is expected to remain above peers, averaging at 27% of turnover over the next three years (median of 26% for A3-rated peers). Whilst the HA's operations are hindered by the prolonged high inflation, whg is planning efficiencies to maintain its margin.

The HA will face higher costs due to: i) repairs and maintenance costs increasing due to material and labour shortages, ii) labour shortages which drive staff costs for both new and existing staff and iii) costs to develop new units increased to £142k from £126k per unit, impacting negatively market sales margins. However, whg has responded to these pressures, by better utilising its workforce relating to repairs, reviewing its recruitment policy around vacant posts as well realising procurement savings and efficiencies. The group also identified £88 million of possible cost savings, as an additional buffer if required.

Whg's operating margin has remained at 27% in fiscal 2022 (above the A3-rated peer median of 23%). The HA's SHL margin declined to 29% in fiscal 2022 from 32% in the previous year. The reduction was driven by an increase in management costs (+£2.8 million) as whg invested in customer services, and in expenses linked to maintenance and major repairs (+£2 million) due to inflation and the covid-19 backlog. On the other hand, first-tranche shared ownership (FTSO) margins improved to 18% in fiscal 2022 from 11% in the previous year, as the units were sold at a higher valuation and initial share than previous years.

Whg's solid interest cover metrics will remain above A3-rated peers. SHLIC continued to perform strongly at 1.5x in fiscal 2022, exceeding the A3-rated peer median of 1.1x. We expect this metric to improve thanks to whg's deleveraging, averaging at 2.0x over the next three years.

Whg's cash flow volatility interest cover (CVIC) is expected to remain strong, averaging 2.8x over the next three years relative to the A3-rated peer median of 1.6x. Whg's CVIC was 2.4x in fiscal 2022, above the A3-rated peer median of 1.7x, reflecting its stable operating cash flows derived from low-risk SHL.

Strong financial management and sustained concentration on low-risk SHL

Whg continues to focus on its core business of managing and delivering social and affordable housing with exposure to those tenures remaining significantly above A3-rated peers. SHL constituted 88% of turnover in fiscal 2022, compared to the A3-rated peer median of 76% in fiscal 2022. The strong focus on SHL means that whg is less exposed to more volatile and often less profitable revenue streams such as market sales. This is credit positive, especially as the weakening housing market over the next years may put pressure on market sales. Market sales (FTSO and outright sales) will only account for 6% of turnover over the next three years, a decrease from 9% in fiscal 2022.

In order to ensure it has sufficient financial resilience, whg established 9 financial Golden Rules. These include: 1) a minimum level of 130% headroom on its interest cover covenant with a trigger at 135% (headroom we deem as tight), 2) a minimum of £20 million of liquidity held with a trigger at £30 million, 3) headroom of unencumbered assets at 10% of charged security with a trigger of 15%, 4) liquidity to meet capital commitments and debt repayments over the next 18 months, with a review at 24 months, 5) sales turnover capped at 20% of turnover net of sales with a trigger of 15%, 6) open market sales capped at £20 million with a trigger at £17.5 million, 7) net development costs capped at 75% of turnover with a 70% trigger, 8) a rule to maintain gearing at 60% (headroom we deem as tight) with a trigger at 55% and 9) to maintain SHLIC at 1.5x with a trigger at 1.6x.

Those rules are broader and tend to be more stringent when compared to peers. Whg's management put in place multivariate stress testing to provide assurance of financial viability under a range of adverse scenarios, as well as tolerance testing, which assesses to what extent a variable (such as inflation or a decline in house prices) can change before it causes a covenant breach. Such testing coupled with mitigation measures around cost savings is credit positive, considering the high inflationary pressures observed in the UK.

Whg's sound financial management is illustrated by the recent reduction in development targets and in development of planned market sales because of inflationary pressures and an increased likelihood of a housing market downturn. Whg is also working on minimising its cost of funding. The HA expects to deliver a £5 million net interest expense saving in fiscal 2024, thanks to its refinancing exercise. Whg also renegotiated its covenants to increase headroom.

Supportive institutional framework in England

The sector's credit quality will continue to benefit from the strong institutional framework governing English housing associations (HAs) reflected in an Operating Environment score of a3 and a Regulatory Framework score of a1. These scores are assigned at a national level and reflect the following credit considerations:

The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and by undertaking biennial In-Depth Assessments (IDAs) for large and complex HAs. The regulator has a strong track record of intervention in cases of mismanagement or financial stress with powers to provide financial assistance and/or make manager appointments where there has been a breach of regulatory standards.

The operating environment for English HAs remains supportive. Demand for social housing remains very high and the government has committed to increased capital grant on more flexible terms for new social housing. English HAs retain some expenditure flexibility and have a track record of reducing costs to mitigate lower income.

However, due to presently very high rates of inflation, the government has intervened on social rent policy with a 7% ceiling on social rent increases to be implemented from April 2023 for one year. The ceiling of 7% will likely result in an adverse differential between rental income and cost growth, driving lower margins and interest coverage. The intervention introduces policy volatility to the sector as the ceiling will supersede the allowable increase of consumer price inflation (CPI) plus 1% under the current rent standard, which is in place until March 2025.

Increased capital spending due to moderate development ambitions and increased investment in stock

Whg's net capital expenditure will increase to an average of 42% of turnover over the next three years, from 8% in fiscal 2022. The increase will be driven by its development programme as well as retrofitting works.

Whg plans to build 2,040 units over the next five years (9% of its current units), as well as 67 outright sale units through a joint venture. This will represent an average of 421 new units a year, in line with the 418 new units delivered in fiscal 2022. The developed units will mostly be SHL, with only 265 shared ownership units and 93 units for outright sales. Whg chose to decrease its development programme compared to last year and in particular to reduce its market sales exposure (where on average 72 units for outright sales were planned to be developed annually over five years, compared to 19 in the new plan), a mitigant against the weakening operating environment. Whg secured grant funding with Homes England as it was selected as a strategic partner under its Wave 2 funding programme, expecting to receive a grant of £39 million.

Following an in-depth stock review, the group revised its estimate of how many properties are below EPC-C to 10,412 from the 5,318 properties previously assumed. While this will result in greater retrofitting costs, the business plan continues to demonstrate capacity to fund retrofitting. Retrofitting costs are estimated at £63 million (all capitalised) from fiscal 2023 to fiscal 2027, well above the £14 million assumed in the previous plan from fiscal 2022 to fiscal 2026.

Relatively high gearing, mitigated by substantial liquidity

Whg has a relatively weak balance sheet, mainly as a result of its large-scale voluntary transfer (LSVT) origins. In fiscal 2022, whg's gross debt stood at £463 million, an increase of £75 million from fiscal 2021. We expect whg's debt to be at £461 million in fiscal 2027, similar to the level observed in fiscal 2022, thanks to the groups' debt restructuring and early refinancing of historical loans.

Gearing has significantly improved to 49% in fiscal 2022 from 85% in fiscal 2015 and is now slightly below the A3-rated peer median (50%). Gearing is expected to increase to 52% on average over the next three years, matching the A3-rated peer median. The gearing increase will be primarily driven by an anticipated reduction in cash balances and to a lesser extent by the debt increase from fiscal 2024 (or 2025 should delays in development continue). Whg anticipates to reduce its cash balance to £28 million in fiscal 2023 from £150 million the year before.

Despite the debt increase, debt to revenues continues to be below the median in fiscal 2022 (3.8x compared to 4.3x for A3-rated peers) and is expected to remain lower than peers.

Whg's relatively high debt is partially mitigated by its simple debt structure and its ample cash balance, albeit this balance is expected to decrease. Whg's debt bears low risk with most of its drawn debt (88%) being at a fixed rate, and only 15% is to be repaid within five years. Most of whg's debt has a bullet repayment profile, with the main risk being a long-term one; its £250 million bond maturing in fiscal 2046.

As of December 2022, whg has immediately available liquidity sufficient to cover 1.6x of its two year cash needs (the liquidity coverage ratio would increase to 1.9x if additional cash equivalents with a notice period between 35 and 125 days are included). Whg has recently boosted its liquidity by increasing its revolving credit facilities (RCF) by £20 million in September 2022. The HA will further enhance its liquidity by reimbursing a £56 million loan and replacing it with a £150 million RCF before fiscal year-end 2023.

Whg's unencumbered assets position is also strong with £322 million of additional borrowing capacity as of December 2022, which compares positively with its net funding needs. Whg recently improved its unencumbered asset position by switching to MVS-TT (Market Value Subject to Tenancy) valuation.

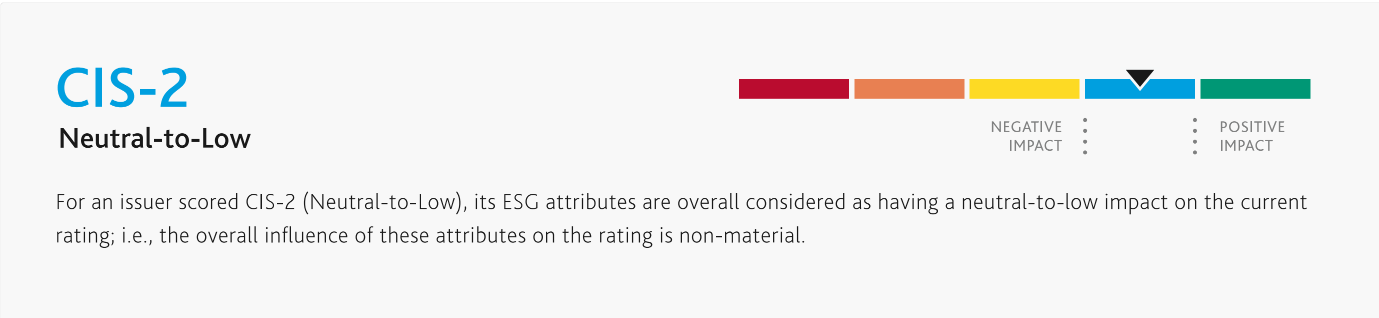
Extraordinary Support Considerations

The strong level of extraordinary support factored into the rating reflects the wide-ranging powers available to the regulator in cases of financial distress, with the possibility of a facilitated merger or a transfer of engagements. However, the process can be protracted and is reliant on HAs agreeing to merge, which could be more challenging in a weakening operating environment. Recent history has shown that the UK government is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support assumption also factors increasing exposure to non-core social housing activities in the sector, that add complexity to HA operations, and the weakening of the sovereign's financial resilience, making an extraordinary intervention slightly more challenging. In addition, our assessment that there is a very high default dependence between whg and the UK government reflects their strong financial and operational linkages.

ESG considerations

Walsall Housing Group Ltd's ESG Credit Impact Score is Neutral-to-Low CIS-2

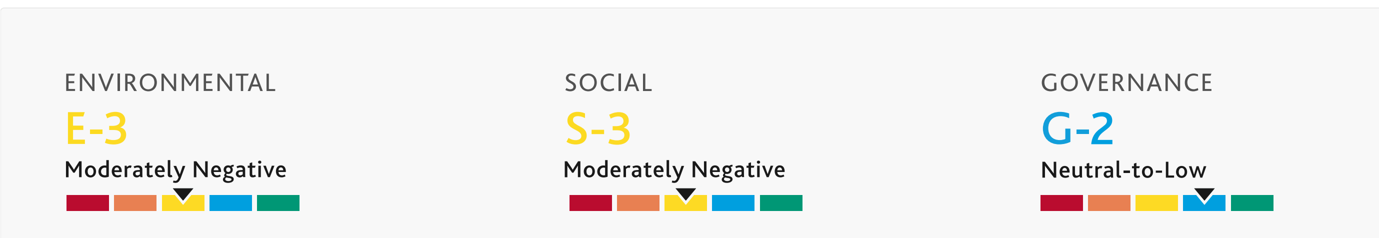
Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

whg's CIS is neutral-low reflecting moderate exposure to environmental and social risks, low-neutral governance profile, as well as a supportive regulatory framework and support from the UK government.

Exhibit 4
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

Its overall E issuer profile score is moderate (**E-3**), reflecting moderately negative exposure to environmental risks, primarily due to carbon transition risk from the legislative requirement for English housing associations to improve the energy efficiency of their existing housing stock by 2035, leading to increased expenditure. We consider that whg has a material exposure to this risk due to a significant proportion of its stock requiring retrofit.

Social

We assess its S issuer profile score as moderate (**S-3**), reflecting exposure to risks from responsible production and demographic and societal trends. Responsible production risks include the legislative requirement to improve the safety of its existing housing stock which will increase expenditure over the medium term. Demographic and societal trends risks reflect the vulnerability of the sector to government policy which controls rent setting in England and Wales. The government's recent intervention on social rent policy with a ceiling on social rent increases introduces policy volatility to the sector and will have a negative impact on financial performance.

Governance

We assess its G issuer profile score as neutral to low (**G-2**). Governance in the sector is generally fit for purpose, with good oversight of business risks, strong financial planning and risk management processes, detailed reporting and simple organisational structures. The regulatory framework also supports good governance in the sector.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating Methodologies and Scorecard Factors

The assigned BCA of baa1 is close to the scorecard-indicated BCA of a3.

The methodologies used in this rating were the European Social Housing Providers rating methodology, published in April 2018, and the Government-Related Issuers rating methodology, published in February 2020.

Exhibit 5
As per 31 March 2022

Walsall Housing Group			
Baseline Credit Assessment	**Sub-factor Weighting**	**Value**	**Score**
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	21,933	a
Factor 3: Financial Performance			
Operating Margin	5%	26.6%	a
Social Housing Letting Interest Coverage	10%	1.5x	baa
Cash-Flow Volatility Interest Coverage	10%	2.4x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.8x	baa
Debt to Assets	10%	49.2%	ba
Liquidity Coverage	10%	1.6x	a
Factor 5: Management and Governance			
Financial Management	10%	a	a
Investment and Debt Management	10%	baa	baa
Scorecard - Indicated BCA Outcome			**a3**
Assigned BCA			**baa1**

Source: whg, Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
WALSALL HOUSING GROUP LTD	
Outlook	Stable
Baseline Credit Assessment	baa1
Issuer Rating -Dom Curr	A3
WHG TREASURY PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

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