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CREDIT OPINION
27 October 2022

Update

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RATINGS

ClwydAlyn Housing Limited

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

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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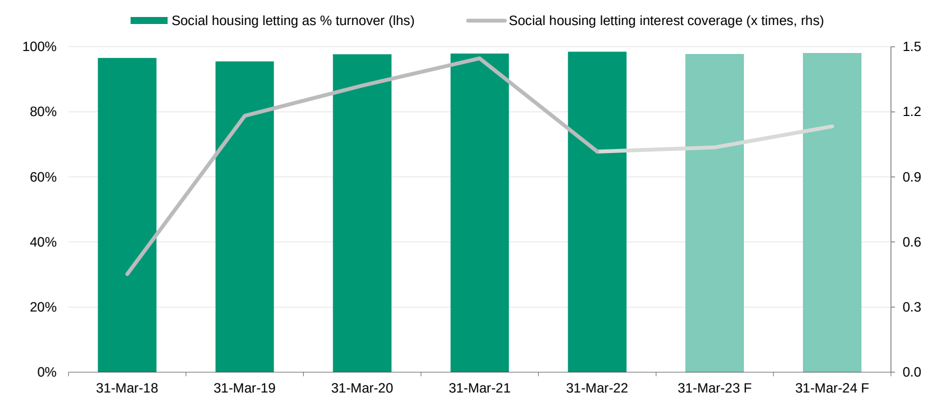
ClwydAlyn Housing Limited (UK)

Update following outlook change to negative from stable

Summary

The credit profile of ClwydAlyn Housing (ClwydAlyn, A3 negative) reflects its high proportion of revenue derived from low-risk social housing lettings, which enhances revenue stability; its strong market position in North Wales; and its sound management. The rating also reflects the high indebtedness and lower margins than peers. ClwydAlyn benefits from the strong regulatory framework governing Welsh housing associations and our assessment that there is a strong likelihood that the government of the United Kingdom (UK, Aa3 negative) would intervene in the event that it faced acute liquidity stress.

Exhibit 1
ClwydAlyn continues to maintain a high proportion of social housing lettings



F: Forecast. In FY2018, ClwydAlyn's social housing letting interest coverage (SHLIC) was reduced due to one-off breakage costs
Source: ClwydAlyn, Moody's Investors Service

Credit strengths

» Continued focus on low-risk social housing letting supporting cash flow stability

» Development ambitions supported by added grants and strong management practices

» Supportive operating environment and regulatory framework

Credit challenges

» High debt burden, but lower gearing than peers

» Low operating margins

Rating outlook

The negative outlook reflects the high exposure to weaker economic and financial conditions in the UK. Probable limitations on social rent increases decided by the Welsh government combined with high cost inflation will weigh on operating margins over the next 12 to 18 months. At the same time, rising interest rates and tightening financing conditions will further weaken interest coverage ratios.

Factors that could lead to an upgrade

A rating upgrade is unlikely due to the negative outlook. The negative outlook could be stabilised if ClwydAlyn is able to maintain relatively stable financial metrics over the medium term. This could be driven by operating performance improving, including the ability to contain cost pressures, and reductions in development plans leading to lower debt levels than previously anticipated.

Factors that could lead to a downgrade

The ratings could be downgraded as a result of one or a combination of the following: a failure to adapt strategies to mitigate against weaker economic conditions; a sustained weakening in operating margins and interest coverage ratios; increases in debt levels beyond that currently anticipated; significant deteriorations in liquidity; significant scaling up in market sales exposure; or any weakening of the regulatory framework or dilution of the overall level of support from the UK government. A downgrade of the UK sovereign rating would also place downward pressure on the ratings.

Key indicators

ClwydAlyn	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.)	5,794	5,998	6,048	6,240	6,296	6,236	6,732
Operating margin, before interest (%)	27.5	21.7	22.6	23.6	17.6	18.9	21.6
Net capital expenditure as % turnover	73.3	14.1	33.4	12.8	21.0	52.5	83.4
Social housing letting interest coverage (x times)	0.5	1.2	1.3	1.4	1.0	1.0	1.1
Cash flow volatility interest coverage (x times)	0.5	1.3	1.5	0.8	2.1	0.6	1.1
Debt to revenues (x times)	5.1	4.7	4.4	4.7	4.8	4.7	5.0
Debt to assets at cost (%)	46.3	45.6	45.8	44.5	42.2	37.9	39.0

F: Forecast. In FY2018, ClwydAlyn's SHLIC and cash flow volatility interest coverage (CVIC) took a hit from one-off breakage costs, as part of a debt refinancing exercise.
Source: Moody's Investors Service, ClwydAlyn

Detailed credit considerations

On 25 October 2022, Moody's changed the outlook to negative from stable and affirmed ClwydAlyn's ratings. The change in outlook followed Moody's change in outlook of the Government of the United Kingdom's Aa3 rating to negative from stable on 21 October 2022.

Baseline credit assessment

Continued focus on low-risk social housing letting supports cash flow stability

Low-risk social housing lettings, including supported and sheltered housing, contributed 98% of ClwydAlyn's turnover in FY2022, a level virtually unchanged since FY2014. This compares favourably with our rated peers, which derived 76% of their revenue from social housing lettings in FY2022. We expect ClwydAlyn's proportion of turnover from social housing lettings to remain at 98% over the next five years.

Over half of the group's income is generated from housing benefits, care home fees funded by local authorities and government contracts to provide supporting living services - this backing of a significant proportion of revenue by government bodies is also credit positive as it reduces the risk of revenue losses. During the pandemic, the HA benefitted from additional funding from the Welsh Government for both its social housing activities (furlough) and its care activities, a positive. In FY2022, it benefitted from an additional £0.2 million grant to distribute one-off bonus for care staff and £1 million grant income to fund refugees and homeless projects.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.

ClwydAlyn is one of the largest housing associations in Wales with 6,296 units under management and a turnover of £49 million in FY2022. It has the biggest market share in North Wales, a dispersed area with the second-biggest population concentration after the more urbanized south. ClwydAlyn's major operations are spread across seven local authorities in Wales.

Development ambitions supported by added grants and strong management practices

ClwydAlyn's 2023-2027 development programme includes 1,563 units, or 25% of ClwydAlyn's stock as of FY2022. Consequently, the projected net capital spending over the next three years is ambitious, averaging above 50% of turnover. Although this is high, we note that ClwydAlyn benefits from high grants from the Welsh Government as this is in line with its ambitions to build 20,000 new eco-homes across Wales. Besides, ClwydAlyn has benefitted from new funding from the Welsh Government to address inflationary pressures on development (Material Cost Increase grants), the HA already benefitted from four waves of this newly created funding.

89% of the units built are planned to be general needs units and only 143 units being rent to own plus 23 supported housing. This is credit positive as ClwydAlyn will benefit from very strong demand on those and stable cash flows. We note that the HA has a high flexibility to convert tenure of newly built stock in intermediate rent, which also benefit from very strong demand, and generate higher margins, an added flexibility.

We view ClwydAlyn's management and governance in line with peers, with established golden rules on interest covers and gearing, aligned to its covenants to monitor its financial performance and detailed scenario analysis and stress testing. Its liquidity policy is in line with others in the sector with 12 months of forecast cash outflows held as cash and immediately accessible funding and 24 months of forecast cash outflows held as cash, immediately accessible funding and committed, but uncharged, loan facilities.

Supportive operating environment and regulatory framework

ClwydAlyn's credit quality will continue to benefit from the strong institutional framework governing Welsh housing associations (HAs) reflected in an Operating Environment score of a2 and a Regulatory Framework score of a1. These scores are assigned at a national level and reflect the following credit considerations:

The Housing Regulation Team (HRT), a departmental office sitting within the Welsh Government, regulates Welsh HAs. The HRT is responsible for protecting the public investment in social housing as well as ensuring that HAs are financially viable, well-governed and deliver high quality homes and services. The regulator monitors compliance with standards of performance through quarterly returns, long-term business plans, stress tests and regular interaction with senior management. In the latest regulatory assessment from March 2022, ClwydAlyn retained the highest scores (Green) for both Governance and Service Delivery and for Financial Management.

The operating environment for Welsh HAs remains supportive, with a very high demand for social housing. The Welsh government has committed to increased capital grants on more flexible terms for new social housing and introduced material cost increase grants to help HAs mitigate the impact of inflationary pressures on development.

However, due to presently very high rates of inflation, the Welsh government is likely to limit social rent increases as allowed by the social rent policy when inflation is above 3% (the policy is to increase rents by CPI+1% otherwise). A potential ceiling may result in an adverse differential between rental income and cost growth, driving lower margins and interest coverage. Nonetheless, we view the Welsh operating environment as more favourable than the English one as a result of a higher level of grants and less policy volatility.

High debt burden, but lower gearing than peers

ClwydAlyn's debt levels are expected to increase to £284 million by FY2025, from £234 million at FY2022, to fund its development programme. However, debt-to-revenues is expected to average of 4.8x over the next three years, higher than the A3 peer median of 4.6x over the same period, and in line with FY2022 level of 4.8x for ClwydAlyn.

Despite the debt growth, gearing is expected to improve, averaging 39% over the next three years from 42% in FY2022, as the HA will benefit from high grant funding. Gearing is stronger than the expected A3 peer median of 54% over the same period, highlighting the more favorable Welsh grant regime, compared to the English one.

ClwydAlyn's debt profile presents no interest rate risk with 100% of its debt at fixed rates (including hedges) as of March 2022. It also presents low short-term refinancing risk, with 98% of debt due after more than five years as of fiscal 2022. Its main refinancing risk lies with its £185 million bond, maturing in fiscal 2052, but we note that the bond is repayable in several installments starting in 2038.

ClwydAlyn's unencumbered assets allow for a borrowing capacity of £114 million, which compares well with its funding needs, £90 million for its 5-year development programme.

Low operating margins

ClwydAlyn had an operating margin of 18% in FY2022, which is low compared to the A3 peer median of 25%. ClwydAlyn's 2022 margin was negatively impacted by labour shortage as the HA had to hire subcontractors on top of inflation on maintenance and repairs costs. Welsh housing associations have generally lower margins relative to their English peers. In addition, ClwydAlyn's portfolio includes some supported housing and care activities which have high cost structures.

ClwydAlyn's operating margin will remain low, averaging 21% over the next 3 years as growth and rent increases will mostly be offset by inflationary pressures as well as increased maintenance costs. HAs are anticipating their utility bills to increase significantly. Material and labour shortage have increased HAs' maintenance and repair costs. The cost-of-living crisis also increases the risk of higher arrears for the sector. ClwydAlyn remains committed to delivering value for money efficiencies through improving voids, which increased due to the pandemic, and consolidating its care activity offering.

ClwydAlyn's social housing lettings interest coverage (SHLIC) of 1x in FY2022 is slightly lower than the A3 peer median of 1.1x and has deteriorated over the past year because of the increased maintenance costs. This is expected to slightly improve by FY2024, in line with its operating margin and supported by stable interest payments.

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 ClwydAlyn and the UK government reflects their strong financial and operational linkages.

ESG considerations

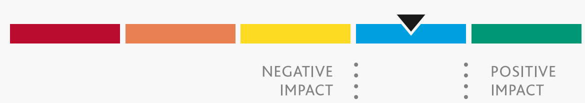
ClwydAlyn Housing Limited's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3

ESG Credit Impact Score

CIS-2

Neutral-to-Low



For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

ClwydAlyn'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 Welsh government.

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-3	S-3	G-2
Moderately Negative	Moderately Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental

Its overall E issuer profile score is moderately negative (**E-3**), reflecting the carbon transition risk from the requirement for Welsh housing associations to improve the energy efficiency of their stock, leading to increased expenditure. We consider that ClwydAlyn has a material exposure to this risk due to a relatively high proportion of its stock requiring retrofit. ClwydAlyn successfully secured grants from the Welsh government grant to help decarbonise its stock (£1 million in fiscal 2023, and £5.7 million expected over the next three years).

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 requirement to improve the safety of its existing housing stock which will increase expenditure over the medium term. Although ClwydAlyn does not have any high-rise nor ACM cladding, the HA anticipates spend of £1 million to replace fire doors in communal areas. Demographic and societal trends risks reflect the vulnerability of the sector to tenant affordability challenges and to government policy which controls rent setting in England and Wales, which weighs on revenue. A potential cap on social housing rent increases introduced by the Welsh government, as allowed by their rent setting policy, would have a negative impact on ClwydAlyn's 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. ClwydAlyn benefits from the highest regulatory scores.

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 methodology and scorecard factors

The assigned BCA of baa1 is one notch above the scorecard-indicated BCA of baa2.

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

31 March 2022

ClwydAlyn			
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%	6,296	baa
Factor 3: Financial Performance			
Operating Margin	5%	17.6%	baa
Social Housing Letting Interest Coverage	10%	1.0x	baa
Cash-Flow Volatility Interest Coverage	10%	2.1x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	4.8x	ba
Debt to Assets	10%	42.2%	ba
Liquidity Coverage	10%	0.8x	baa
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			**baa2**

Source: Moody's Investors Service, ClwydAlyn

Ratings

Exhibit 6

Category	Moody's Rating
CLWYDALYN HOUSING LIMITED	
Outlook	Negative
Baseline Credit Assessment	baa1
Issuer Rating -Dom Curr	A3
PENARIAN HOUSING FINANCE PLC	
Outlook	Negative
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

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