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CREDIT OPINION
14 December 2021

Update

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RATINGS

ClwydAlyn Housing Limited

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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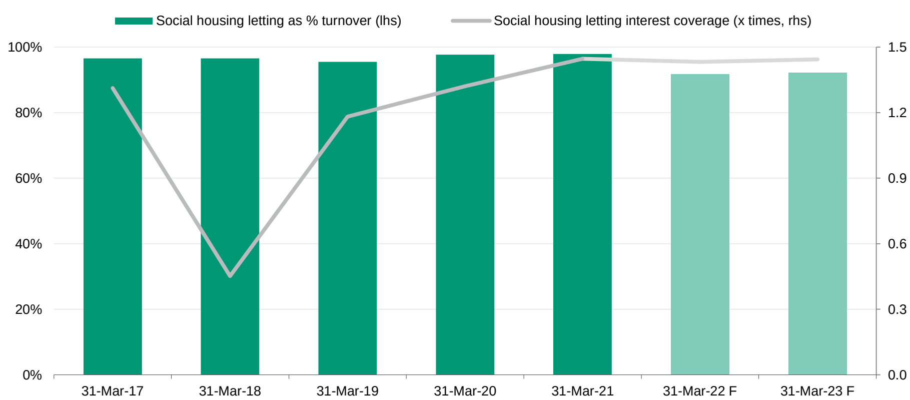
ClwydAlyn Housing Limited (UK)

Update to credit analysis

Summary

The credit profile of ClwydAlyn Housing (ClwydAlyn, A3 stable) 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 liquidity. The rating also reflects the high indebtedness and lower than peers margins. 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 stable) 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) 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

» Strong management and governance underpins sound liquidity

» Supportive operating environment and regulatory framework, which supports revenue stability

Credit challenges

» High debt burden, but lower gearing than peers

» Low operating margins although on an improving trend

Rating outlook

The stable outlook reflects our expectation that ClwydAlyn's financial performance will remain in line with A3 peers.

Factors that could lead to an upgrade

An upgrade of the ratings could result from sustained improvement in financial performance, including social housing lettings interest coverage and cash flow volatility interest coverage above 2.0x and an operating margin above 30%.

Factors that could lead to a downgrade

A downgrade of the ratings could result from the operating margin falling below 20% on a sustained basis, with social housing lettings interest coverage and cash flow volatility interest coverage below 1.0x and debt to revenues metric increasing above 6.0x. In addition, any weakening of the regulatory framework or dilution of the overall level of support from the UK government could also exert downward pressure on the rating.

Key indicators

ClwydAlyn	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22 (F)	31-Mar-23 (F)
Units under management (no.)	5,706	5,794	5,998	6,048	6,240	7,051	7,559
Operating margin, before interest (%)	26.3	27.5	21.7	22.6	23.6	23.9	25.4
Net capital expenditure as % turnover	14.3	73.3	14.1	33.4	12.8	108.1	9.4
Social housing letting interest coverage (x times)	1.3	0.5	1.2	1.3	1.4	1.4	1.4
Cash flow volatility interest coverage (x times)	1.7	0.5	1.3	1.5	0.8	1.6	1.4
Debt to revenues (x times)	4.6	5.1	4.7	4.4	4.7	5.2	5.0
Debt to assets at cost (%)	40.6	46.3	45.6	45.8	44.5	47.2	43.5

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

ClwydAlyn's rating combines (1) its Baseline Credit Assessment (BCA) of baa1, and (2) a strong likelihood of extraordinary support coming from the UK government in the event that the organisation faced acute liquidity stress.

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 FY2021, a level virtually unchanged since FY2014. This compares favourably with our rated portfolio of housing associations in the UK, which, as a whole, derived 80% of their revenue from social housing lettings in FY2021. We expect ClwydAlyn's proportion of turnover from social housing lettings to marginally reduce to an average of 93% over the next three years due to a small amount of rent to own properties being developed over this period, however the vast majority of its development programme is for social rented properties. ClwydAlyn's 2021-2026 development programme includes 1,808 units, with 26 of these being rent to own and the remainder general needs or supported housing.

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.

ClwydAlyn is one of the largest housing associations in Wales with 6,240 units under management and a turnover of £48 million in FY2021. It has the biggest market share in North Wales, a dispersed area with the second-biggest population concentration after the more urbanized south (where cities like Cardiff and Swansea are located). ClwydAlyn's major operations are spread across seven local authorities in Wales.

Strong management and governance underpins sound liquidity

ClwydAlyn has made significant improvements in its management and governance in 2019. This includes implementing golden rules to monitor its financial performance, detailed scenario analysis and stress testing, renewal of its Executive Team and Board as well as improving its liquidity management, including strengthening its liquidity policy.

Its liquidity policy is now 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. As a result, ClwydAlyn's liquidity coverage is strong at 1.1x in FY2021. This includes £30 million of cash and £35 million of immediately accessible facilities through its revolving credit facility.

Supportive operating environment and regulatory framework, which provides revenue stability

Welsh housing associations operate under a co-regulated environment with engaged oversight exercised by the sector's regulator, the Housing Regulation Team (HRT). The HRT is a departmental office sitting within the Welsh government and reports to the Welsh Government Housing Division. The sector's regulator is responsible for protecting the public investment in social housing as well as building confidence to support the reputation and financial viability of the sector. The regulator monitors compliance with standards of performance through quarterly returns, long-term business plans, stress tests and regular interaction with senior management, and focuses on governance, financial viability, value for money and rents.

At least annually, the Welsh ministers publish a regulatory judgement for each housing association in Wales. In the latest assessment from March 2021, ClwydAlyn retained the highest score for both Governance and Service Delivery and for Financial Management.

Social housing rents, which represent the bulk of the revenue for most housing associations, are stable and predictable and their level is set by the Welsh Government, which chose to maintain its existing policy rather than introduce a rent reduction as was seen in England. As of FY2021, the Welsh Governments rent settlement is for CPI+1%, in line with English housing associations.

High debt burden, but lower gearing than peers

ClwydAlyn's debt levels are expected to increase to £265 million by FY2024, from £224 million at FY2021, to fund its development programme. As a result, debt-to-revenues is expected to average of 5x over the next three years, higher than the A3 peer median of 4.3x over the same period, and an increase from FY2021 (4.7x for ClwydAlyn).

However, gearing is expected to remain stable, averaging 44% over the next three years from 45% in FY2021, stronger than the expected A3 peer median of 53% over the same period. ClwydAlyn's debt growth is relatively modest, which reflects the high levels of grant that Welsh housing associations receive to deliver new social housing, in contrast to much lower levels in England.

ClwydAlyn's debt profile represents low short-term refinancing risk, with 98% of debt due after more than five years as of fiscal 2021. Its main refinancing risk lies with its £175 million bond, maturing in fiscal 2052, but we note that the bond is repayable in several installments starting in 2038. As of March 2021, 100% of ClwydAlyn's debt was held at fixed rates (including hedges), above the 70% fixed rate upper bound stated in their treasury policy.

ClwydAlyn's unencumbered assets allow for a borrowing capacity of £79 million, a decent level which compares positively to its funding needs of £17 million of its 5-year development programme.

Low operating margins although on an improving trend

ClwydAlyn had an operating margin of 24% in FY2021, which is relatively low compared to the A3 peer median of 25%. Welsh Housing Associations have generally lower margins relative to their English peers. In addition ClwydAlyn undertaken some supported housing and care activities which typically have weak margins. ClwydAlyn's operating margin will average 25% over the next 3 years as growth and rent increases will be mostly offset by increased maintenance costs to catch-up on covid-19 backlog on repairs and to retrofit units. 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 1.4x in FY2021 is slightly higher than the A3 peer median of 1.3x and has improved over recent years. This is also expected to slightly improve, in line with its operating margin.

Cash flow volatility interest coverage (CVIC) dropped to 0.8x in fiscal 2021, below the A3 rated peer median of 1.7x, as cash flow from operations was negatively impacted by an increase in voids, due to the pandemic. We expect CVIC to return to an improving trend in fiscal 2022 and to average 1.7x over the next 3 years, with interest costs remaining stable over the same period.

Extraordinary support considerations

The strong level of extraordinary support reflects the wide-ranging powers of redress available to the regulator in cases of financial distress, with the possibility of a facilitated merger or a transfer of engagements. 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 in the increasing exposure to non-core social housing activities in the sector, which 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 links.

ESG considerations

How environmental, social and governance risks inform our credit analysis of ClwydAlyn Housing

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of ClwydAlyn, the materiality of ESG to its credit profile is as follows:

Environmental considerations are material to ClwydAlyn's credit profile. Although the impact of physical climate risks such as water shortages and flood risk are unlikely to be material to HAs' credit profiles as they are managed by government authorities, energy efficiency and decarbonisation more broadly are becoming an increasingly acute priority for HAs, with a target of all homes obtaining an energy performance certificate (EPC) of C or above by 2035 in the UK. Wales ambitions to meet the target earlier and is funding projects like the Optimised Retrofit Programme, with £50 million a year for the next 4 years, which ClwydAlyn expects to benefit from. We expect this to require material levels of capital expenditure - which would either divert cash flows away from development programmes or increase debt levels. ClwydAlyn has included achieving EPC rating of less than D for all its properties by 2023 in its business plan.

Social risks are material to HAs' credit profiles. In particular, the sector is exposed to risks stemming from socially-driven policy agendas affecting social rents, benefits and capital grants in addition to the impact of demographic trends on demand which are captured in our assessment of the operating environment. We view the coronavirus pandemic as a social risk under our ESG framework given its impact on health and safety. HAs are also impacted by customer relations and product quality. The Grenfell fire tragedy in June 2017 has encouraged higher health and safety standards with many HAs planning on increasing spending on the quality of their existing stock.

Governance considerations are also material to HAs' credit profiles and are captured in our assessment of governance and management. In general, housing association governance is strong with multi-year strategies supported by detailed forecasts, conservative liquidity policies, and robust risk management including stress testing.

Further details are provided in the "Baseline credit assessment" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks.

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 2021

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%	6,240	baa
Factor 3: Financial Performance			
Operating Margin	5%	23.6%	baa
Social Housing Letting Interest Coverage	10%	1.4x	baa
Cash-Flow Volatility Interest Coverage	10%	0.8x	b
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	4.7x	ba
Debt to Assets	10%	44.5%	ba
Liquidity Coverage	10%	1.1x	a
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 4

Category	Moody's Rating
CLWYDALYN HOUSING LIMITED	
Outlook	Stable
Issuer Rating -Dom Curr	A3
PENARIAN HOUSING FINANCE PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

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