Research Update:

U.K.-Based Social Housing Provider Notting Hill Genesis Outlook Revised To Negative; 'A-' Rating Affirmed

September 13, 2024

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Overview

- The financial performance of Notting Hill Genesis (NHG) will remain structurally weaker than previously expected since the group accommodates larger investments on its existing properties.
- While we estimate NHG's debt will reduce as the group disposes of large stock and reduces its development targets, lower adjusted non-sales EBITDA will weigh on its already weak debt metrics.
- We revised the outlook to negative because of the risks associated with NHG's ambitious plans to reduce debt, which could prevent a strengthening of its financial metrics.
- We affirmed our long-term issuer credit rating on NHG at 'A-'.

Rating Action

On Sept. 13, 2024, S&P Global Ratings revised its outlook on the long-term rating on U.K. social housing provider NHG to negative from stable. At the same time, we affirmed our 'A-' long-term issuer credit rating.

We also revised the outlook to negative and affirmed our 'A-' long-term issuer credit rating on NHG's subsidiary, Notting Hill Home Ownership Ltd. (NHHO).

We affirmed our 'A-' issue ratings on all six bonds and the £2 billion senior unsecured medium-term note program issued by NHG. We also affirmed the 'A-' issue rating on the £250 million bond, due 2039, issued by the treasury vehicle GenFinance II PLC, considered a core subsidiary of the group.

Outlook

The negative outlook reflects the risk that NHG's financial metrics may not recover as we currently forecast, and the group's headroom to cope with cost pressures has significantly tightened.

Downside scenario

We could lower the rating in the next 24 months if NHG is unable to effectively contain spend or deliver on its asset disposal program. This could result in higher-than-estimated debt funding needs and prevent a recovery of the group's financial metrics. In our view, this would also indicate a more aggressive strategy than what is currently assumed.

We could also lower the rating if we believed there was a reduced likelihood of timely extraordinary support from the U.K. government.

Upside scenario

We could revise the outlook to stable if NHG manages to sustain the projected strengthening of its S&P Global Ratings-adjusted EBITDA. This, combined with a steady reduction of debt, would strengthen its debt metrics.

Rationale

The outlook revision reflects the risk that NHG's financial metrics may remain weaker for longer than we anticipate. There are further risks to NHG's steady reduction of debt since it is largely dependent on the group effectively delivering on its stock rationalization program.

We estimate that since the group carries larger investments on its existing properties, its adjusted EBITDA margins will structurally weaken compared to our previous expectations. Therefore, we also revised down to 'bbb' from 'bbb+' our stand-alone credit profile (SACP) on NHG.

The rating reflects our expectation that NHG's management will deliver on its targeted debt, limit exposure to sales activities, and sustain a solid liquidity position.

Enterprise profile: Supported by NHG's strong operational metrics and a limited exposure to sales

NHG benefits from generating most of its earnings in the predictable and countercyclical social housing sector, supported by a solid market position and generally cautious approach to sales risk.

NHG has a large asset base since it owns and manages more than 67,000 homes concentrated mainly across London. We believe this increases the group's resilience to withstand external shocks. In our view, demand for NHG's core services is supported by a significant gap between NHG's average rent for general needs and the market rent, which we estimate to be below 50%. Demand for NHG's properties is also reflected in its average vacancy rates, which have remained at about 1.5% for three years and are on par with the sector.

NHG continues derisking its plan from market sales exposure and has taken a more conservative approach on properties developed for sale. We estimate that the group's exposure to sales, including those from joint ventures, will be contained below 10% on average throughout our forecast period.

We understand that NHG's management plans to reduce its development targets to accommodate larger investments on existing stock. This will lead to reduced flexibility and pressure on its financial metrics. At the same time, the group's strategy is to dispose of stock from areas outside of London and use part of the proceeds to reduce its debt. While these actions should have a positive impact on NHG's financial metrics, we see risks that the group might not be able to execute the plans as they are set out.

We assess the regulatory framework under which registered providers of social housing in England operate as strong (see "Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks," published Oct. 23, 2023, on RatingsDirect).

Financial profile: Hampered by large investment needs but supported by projected debt reduction and robust liquidity

As the group increases spending on its existing properties, we anticipate that NHG's financial performance will remain structurally weaker through our forecast period when compared to our previous expectations. We expect rent increases will exceed cost inflation in the following years, which will support a modest recovery of its adjusted EBITDA margins, but they will remain below 20%. We note the steady progress to achieve EPC C energy ratings for its housing stock, with 79% compliant at this level. However, fire remediation costs will remain elevated, of which NHG has provisioned more than £50 million. We estimate this will be spent in the next four years and will weigh on its financial performance.

We forecast that lower non-sales EBITDA will weigh on the group's debt metrics despite our expectation that NHG will steadily reduce its debt through fiscal year 2027 (ending March 31). We estimate that debt to non-sales adjusted EBITDA will remain elevated and the non-sales adjusted EBITDA interest cover will remain below 1x before slightly recovering toward the end of our forecast. However, we see risks to this recovery since it hinges on significantly lower capital expenditure (capex) than previously assumed, as well as substantial proceeds from asset disposals. Higher-than-projected capex or a delay in asset disposal proceeds could prevent a recovery of the group's debt metrics as projected under our base case.

While we expect liquidity buffers will reduce as the group progresses with its investments, we forecast NHG's liquidity position will remain very strong over the next 12 months. This is further supported by our view that NHG will continue to have strong access to debt capital markets.

We estimate the group's liquidity sources will cover uses by approximately 1.9x in the next 12 months. This is based on our forecast of liquidity sources exceeding £1 billion, comprising cash, undrawn and available revolving credit facilities, asset sales, grant receipts, and cash from operations (adding back the noncash cost of sales). These sources will cover liquidity uses of close to £530 million, primarily for capital expenditure and debt service payments.

Government-related entity analysis

In our view, there is a moderately high likelihood that NHG would receive timely extraordinary government-related support in case of financial distress. This leads us to apply a two-notch uplift to the SACP to derive the issuer credit rating. Since one of the key goals of the Regulator for Social Housing (RSH) is to maintain lender confidence and low funding costs across the sector, we think it is likely the RSH would try to prevent a default in the sector. We base this view on previous instances where the RSH has mediated mergers or arranged liquidity support from other registered providers in cases of financial distress and think this would also apply to NHG.

Key Statistics

Table 1

Notting Hill Genesis--Key statistics

	--Year ended March 31 --				
(Mil. £)	2023a	2024e	2025bc	2026bc	2027bc
Number of units owned or managed	67,110	67,636	67,453	65,512	62,480
Adjusted operating revenue	715.2	690.1	725.4	782.4	735.5
Adjusted EBITDA	144.1	115.5	115.2	132.4	137.9
Non-sales adjusted EBITDA	130.0	97.0	108.1	118.9	137.0
Capital expense	222.0	328.7	308.7	179.8	118.2
Debt	3,305	3,585	3,655	3,423	3,072
Interest expense	149.3	164.5	161.6	146.5	132.2
Adjusted EBITDA/Adjusted operating revenue (%)	20.1	16.7	15.9	16.9	18.8
Debt/Non-sales adjusted EBITDA (x)	25.4	37.0	33.8	28.8	22.4
Non-sales adjusted EBITDA/interest coverage(x)	0.9	0.6	0.7	0.8	1.0

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

Notting Hill Genesis--Ratings Score Snapshot

	Assessment
Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	2
Management and Governance	3
Financial risk profile	4
Financial performance	5
Debt profile	6
Liquidity	2
Stand-alone credit profile	bbb
Issuer credit rating	A-

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
- 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

Related Research

- The U.K.'s Constrained Fiscal Position Implies Difficult Policy Trade-Offs For The Labour Government, July 8, 2024
- United Kingdom, April 22, 2024
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2024, March 11, 2024
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2024, March 11, 2024
- Non-U.S. Social Housing Providers Ratings History: March 2024, March 11, 2024
- U.K. Social Housing Borrowing 2024: Borrowing capacity remains constrained, March 6, 2024
- Non-U.S. Social Housing Sector Outlook 2024: At A Turning Point?, Nov. 29, 2023
- Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks, Oct. 23, 2023
- U.K. Social Housing Providers' Credit Headroom Could Tighten If The Operating Environment Deteriorates, Oct. 4, 2023
- U.K. Social Housing Providers Set Their Sights On Cyber Risks, Dec. 16, 2022
- Inflation To Erode The Performance Of U.K. Public Finance Sectors, Nov. 29, 2022
- Bulletin: Cap On Rent Increases Is Consistent With Our Base Case For English Social Housing Providers, Nov. 17, 2022
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 2022
- Bulletin: Launch Of Rent Cap Consultation Adds Uncertainty To Creditworthiness Across English Housing Sector, Sept. 1, 2022
- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022

Ratings List

Ratings Affirmed		
Notting Hill Genesis		
Senior Secured	A-	
GenFinance II PLC		
Senior Secured	A-	
Ratings Affirmed; Outlook Action		
	To	**From**
Notting Hill Genesis		
Notting Hill Home Ownership Ltd.		
Issuer Credit Rating	A-/Negative/--	A-/Stable/--