FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Notting Hill Genesis at 'A'; Outlook Negative

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Fitch Ratings - London - 26 Oct 2023: Fitch Ratings has affirmed Notting Hill Genesis's (NHG) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A'. The Outlooks are Negative. A full list of ratings is below.

The Negative Outlook reflects continued high net adjusted debt/EBITDA in the first two years of Fitch's rating case before returning to around 12x from the financial year ending March 2026 (FY26), and the risk that performance does not improve in line with our expectations.

Fitch views NHG as a government-related entity (GRE) of the UK government, which leads to a bottom-up rating approach to its 'a-' Standalone Credit Profile (SCP) with a single-notch uplift to the 'A' IDR.

KEY RATING DRIVERS

Status, Ownership and Control: 'Strong'

NHG is a private, not-for-profit, registered provider (RP) of social housing (SH) in the UK. It is not under the ownership of the UK government and in strict terms has no legal owner. The regulatory framework is robust and the Regulator of Social Housing (RSH) has broad oversight and control of the sector. The regulator's record of close monitoring and intervention in rare cases of distress is a key feature of the sector. In the event of financial distress, we expect a transfer of assets and liabilities to another RP under the direction of the RSH.

Support Track Record: 'Moderate'

Policy influence is moderately supportive of the financial stability of RPs. Regulatory restrictions on government support are unlikely to prevent timely intervention in exceptional circumstances. Although the RSH does not provide a direct guarantee for RP borrowers, and the UK government does not have any ownership of the entities, the

RSH can use its statutory powers to intervene when there are serious concerns about an RP's performance. Fitch believes that RPs facing difficulties would be forced to merge with larger or financially stronger entities, as has been seen in a handful of cases over the last decade.

Regulatory intervention ranges from merely ensuring continuation of activities while a substitute is found, to actively seeking to prevent a default and ensure continued financial viability of the RP. The RSH can place a poorly performing RP under supervision and make statutory appointments to the board. In some extreme cases, it can direct an independent statutory inquiry, which could result in an RP being required to transfer its assets to another RP to protect the interests of tenants and other relevant parties.

Cosmopolitan Housing Association's merger with Sanctuary Housing in March 2013 showed that the regulator's support was also available for entities involved in non-SH activity.

Socio-Political Implications of Default: 'Moderate'

In the unlikely event of financial default, other RPs could act as substitutes with only minor or temporary disruption to the service offered by NHG.

Financial Implications of Default: 'Weaker'

Default would have only a minimal impact on the availability and cost of domestic financing for other RPs, given the number of borrowers in the market and their relative size.

Standalone Credit Profile

NHG's 'a-' SCP reflects 'Stronger' assessments of revenue defensibility and operating risk. It also reflects our forecast of net adjusted debt/EBITDA improving to around 12x from FY26 in our rating case, and comparison with peers in the sector. The rating factors are as follows:

Revenue Defensibility 'Stronger'

The Revenue Defensibility assessment is based on 'Stronger' demand and pricing characteristics. There is sustained high demand for SH across the UK, and any change in the rents that RPs are able to charge is unlikely to materially affect demand. The UK government sets the threshold for annual social rent increases via the Rent Standard, but NHG has flexibility over pricing for its non-social lettings activity, which it uses to cross-subsidise the core business. We believe the regulatory framework aims to maintain compensation for services at a level that supports the solvency of the sector.

NHG anticipates growth will be focused on its London-based core regulated business, and is planning to accelerate the disposal of housing units outside London (approximately 6000), with proceeds supporting its development plans.

Operating Risk 'Stronger'

Operating risk covers operating costs, resource management and capital planning. NHG has well-identified cost drivers and low potential volatility in major items. There are no major supply constraints for labour or resources in terms of amount, cost or timing. NHG has material capex in its development plans over the medium term, but has flexibility to scale back committed schemes, defer uncommitted schemes and switch the tenure of unsold units if necessary. In the event of financial stress, NHG could reduce discretionary expenditure or non-essential repairs and maintenance.

Maintenance and major repairs costs remain high as NHG continues to focus on reinvesting in existing stock. These peaked in FY23 at almost GBP170 million, due to the high inflation environment as well as catching up with a pandemic backlog. NHG also needs to meet regulatory standards, including the requirement for all homes to be energy performance certificate (EPC) grade C or above by 2030. At FY23, around 15% of NHG's stock did not yet meet this standard. NHG estimates an additional spend of GBP33 million for all of units to meet the standard by 2030.

The SH sector also continues to face significant costs relating to fire safety. NHG's financial performance has been affected, as it spent an additional GBP10 million on fire and safety remediation of its core housing units, and expects to further spend more than GBP163 million over the next 10 years.

Financial Profile 'Stronger'

Fitch continues to assesses NHG's financial performance as sound, despite the challenges that have affected the sector over recent years. However, there has been a deterioration in the forecast financial profile, which is reflected in the Negative Outlook. Continued high demand for social and affordable housing, implemented cost-efficiency measures and a development for sale plan should allow NHG to maintain sufficient revenue to service debts and cross-subsidise development of new affordable homes.

NHG will continue to build and provide social and affordable units, and we expect debt to moderately increase to fund capex as per NHG's development plan. Some development will be funded by strategic sales, rather than additional debt. We expect NHG's liquidity to remain strong and believe it will maintain adequate covenant headroom.

NHG's operating performance has been under pressure during the last few years, with leverage peaking in FY23 at above 17x, substantially above last year's rating case scenario of 14.7x. Fitch expects NHG's net debt/EBITDA to improve and return to around 12x in FY26-FY28, a level corresponding with the current SCP. However, as NHG's operating performance in FY24-FY25 will remain under pressure, the expected improvement could become more remote, as reflected in the Negative Outlook.

NHG has reduced its development plan for FY24-28 by about 2400 units, reducing its capex plan by GBP1 billion. The reduced development plan and improving EBIDTA will allow NHG to limit its debt financing needs in the medium term. We expect NHG's debt to peak at about GBP3.7 billion by end-FY25 (FY23: GBP3.3 billion), following investments in new and existing stock. Fitch's rating case scenario expects NHG's turnover to average above GBP800 million in the medium term, with EBITDA averaging about GBP260 million (FY23: GBP90 million). NHG's operating revenue was GBP723 million in FY23 when excluding asset disposals and an amortising grant.

Additional Risk Factors Assessment

Fitch assesses all asymmetric risk attributes as 'Neutral' due to a strong regulatory framework, transparent reporting of information, and a risk-averse debt structure.

Derivation Summary

The 'a-' SCP is driven by our assessment of 'Stronger' revenue defensibility, operating risk and financial profile and a comparison with peers in the sector.

Fitch views NHG as a UK GRE, with a support score of 12.5 based on our assessments. This results in a bottom-up approach, with a one-notch uplift from the SCP to the Long-Term 'A' IDR, reflecting modest links with the government.

Short-Term Ratings

NHG's Short-Term 'F1+' IDR is the higher of two options mapping to a 'A' Long-Term IDR, reflecting the combination of 'Stronger' revenue defensibility and strong liquidity cushion and coverage ratios.

Debt Ratings

Fitch rates NHG's senior secured debt issuances, which are unconditional, unsubordinated, and rank pari-passu with all other debt in the group, in line with NHG's

'A' IDR. Fitch rates NHG's GBP2 billion EMTN programme under these debt levels.

Liquidity and Debt Structure

NHG's board and management have a prudent attitude towards risk and debt. NHG's debt is similar to sector peers, spread across bonds, a revolving credit facility and term loans, with limited near-term maturity. There are some refinancing peaks, especially in FY28 and FY29, but we do not expect any refinancing risk, as NHG generates surpluses and has good access to the debt capital markets and high-value assets on its balance sheet.

At 31 March 2023, total debt outstanding was GBP3.3 billion, including eight public bonds (nominal value of GBP2.3 billion). 99% of drawn debt was fixed-rate, limiting exposure to interest-rate risk. NHG generally borrows and lends only in sterling, which minimises currency risk. When it does borrow in a foreign currency, all associated cash flows are hedged to mitigate the risk.

At 31 March 2023, NHG had cash and undrawn facilities available of around GBP1.1 billion. This comprised GBP1.025 billion undrawn bank facilities and GBP60 million of unrestricted cash. It has over 17,000 unencumbered properties, with a security value of GBP2.7 billion. Its reduced development programme is expected to deliver an additional 7,500 units over the next 10 years, which could be securitised should the need for additional financing arise. This is more than sufficient to cover NHG's forecast borrowing requirements.

Issuer Profile

As of 31 March 2023, NHG owned or managed more than 67,000 housing units, ranking it among the largest RPs in England and a constituent member of the G15, the biggest RPs in London. NHG has strong growth aspirations and aims to provide as many affordable homes for residents as possible, with 4,600 units planned for development or acquisition by FY28.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Inability to maintain net debt/EBITDA below 12x on a sustained basis, a multi-notch downgrade of the sovereign's ratings, or an adverse change to our assessment of key rating factors.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

A sustained improvement in net debt/EBITDA below 12x in the medium term could lead to a revision of the Outlook.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR
GenFinance II PLC		
senior secured	LT A Affirmed	A
Notting Hill Genesis	LT IDR A Rating Outlook Negative Affirmed	A Rating Outlook Negative
	ST IDR F1+ Affirmed	F1+
	LC LT IDR A Rating Outlook Negative Affirmed	A Rating Outlook Negative

	LC ST IDR	F1+	Affirmed	F1+
senior secured	LT	A	Affirmed	A

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Apr 2023) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

GenFinance II PLC	UK Issued, EU Endorsed
Notting Hill Genesis	UK Issued, EU Endorsed

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