Research Update:

U.K.-Based Social Housing Provider Notting Hill Genesis Affirmed At 'A-'; Outlook Stable

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Overview

- Although Notting Hill Genesis (NHG) is spending more on existing properties, we anticipate S&P Global Ratings-adjusted EBITDA margins will remain above a modest 20%.
- Nevertheless, because of lower EBITDA and higher interest rates, NHG's debt metrics are unlikely to strengthen even after the group downsizes its capital investment program.
- We affirmed our long-term issuer credit rating on NHG at 'A-'. The outlook is stable.

Rating Action

On Sept. 20, 2023, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on U.K. social housing provider Notting Hill Genesis. The outlook is stable.

In addition, we affirmed our 'A-' long-term issuer credit rating on NHG's subsidiary, Notting Hill Home Ownership (NHHO). The outlook is stable.

At the same time, we affirmed our 'A-' issue ratings on all five 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 stable outlook on the long-term rating on NHG reflects our view that the scaling back on the targets for the development of new homes will counterbalance the rising spending on existing properties and result in a modest weakening of NHG's financial indicators.

Downside scenario

We could lower the rating if the group's management cannot control inflationary pressures on its cost base or deviates from the substantially lower development targets. These developments would weaken NHG's financial performance and further constrain debt metrics. We could also lower the rating if we observed a reduced likelihood of timely extraordinary support for NHG from the U.K. government.

Upside scenario

We could raise the rating if management sustained improved debt metrics by strengthening the group's EBITDA margins while maintaining modest exposure to sales activities.

Rationale

The rating affirmation reflects our expectation that NHG will stick to its latest approved business strategy. We assume NHG will make an effort to contain debt accumulation and that it will reduce its targets for the development of new homes as well as partially fund capital expenditures with proceeds from the sale of fixed assets and grants. Lower exposure to sales activities, a strong demand for NHG's core service and a robust liquidity position counterbalance a modest weakening of its financial indicators.

Enterprise profile: NHG's strong market fundamentals balance volatility from modest exposure to sales activities

NHG's large asset base of over 67,000 homes and in highly solicited areas of operations in and around London helps the group to withstand external shocks. As such, NHG enjoys a stable stream of revenue from traditional business activities.

In addition, we believe demand is strongly supported by a general needs average rent at a low of about 53% of the prevailing market rent. This is reflected in average vacancy rates of about 1.6% over the past three years, which are on par with those of the overall sector.

We forecast that the group's exposure to sales activities, including that through joint ventures, will remain modest over the coming two years, averaging well below a third of the group's total revenues. The group has made significant progress on its target of reducing unsold homes. It has been conducting bulk sales since fiscal 2019, containing development-for-sales and reducing its exposure to this riskier activity.

In order to cope with pressures from the high inflation and high interest rate environment, NHG management has upheld its priority to increase investments on existing stock by scaling down the development of new homes. As such, we now assume that NHG will deliver close to 1,000 homes a year, versus the previous 1,400 target. Also, the group aims to steadily reduce debt. This should yield a steady improvement in the group's financial metrics, but benefits would not materialize until beyond our forecast horizon. Furthermore, although the group's executive team has experienced turnover in the last 12 months, we believe the current management has sufficient expertise to address upcoming difficulties.

We regard the group's risk management as prudent. It conducts robust stress testing and employs timely decision-making, leading to successful mitigation of potential risks, while keeping metrics stable.

We assess the regulatory framework under which registered providers of social housing in England operate as strong (see "Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers," published June 8, 2021, on RatingsDirect).

Financial profile: A substantial reduction on the development targets will somewhat soften the impact of rising investments on existing properties

We expect that, over the coming two years, NHG will effectively manage the strain on its operating cost base and benefit more from the gap between rental revenues increases and costs growth. This will support the estimated recovery in adjusted EBITDA margins, which we forecast will remain modestly above 20%.

Although we anticipate that the group's debt will increase more slowly than we previously forecasted, lower non-sales EBITDA will keep NHG's debt levels elevated. Our estimated lower debt funding requirement follows the group's decision to scale back the development of new homes and our expectation that NHG will fund some of its capital spending with available grants and the proceeds of disposals of fixed asset, as per the group's strategy to reduce its areas of operations and increase concentration in London.

We forecast NHG's liquidity position will remain very strong over the next 12 months, even though liquidity buffers are likely to reduce as the group pursues its investments. We also assume NHG will continue to have strong access to the debt capital markets.

We estimate that the group's liquidity sources cover uses by approximately 2.1x in the next 12 months. This is based on our forecast of liquidity sources of about £1.37 billion comprising cash, undrawn and available revolving credit facilities, asset sales, grant receipts, and cash from operations (adding back the noncash cost of sales) that will cover liquidity uses of about £639 million (mainly 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 one-notch uplift to our assessment of NHG's stand-alone credit profile (SACP) to derive the issuer credit rating. Since one of the Regulator for Social Housing's (RSH's) key goals is to maintain lender confidence and low funding costs across the sector, we think it is likely that the RSH would try to prevent a default in the sector. We base this view on RSH's track record of mediating mergers or arranging liquidity support from other registered providers in cases of financial distress, and we think this would also apply to NHG.

Table 1

Notting Hill Genesis--Key Statistics

	--Year ends March 31 --				
(Mil. £)	**2022a**	**2023e**	**2024bc**	**2025bc**	**2026bc**
Number of units owned or managed	67,691	67,110	66,037	66,326	65,235
Adjusted operating revenue	822.5	715.2	691.2	710.5	880.4
Adjusted EBITDA	197.0	144.4	150.1	169.1	203.0
Non-sales adjusted EBITDA	165.0	132.1	141.0	160.9	163.9
Capital expense	215.9	222.0	429.1	501.1	452.7
Debt	3,352.5	3,305.2	3,306.9	3,680.2	3,652.1
Interest expense	143.1	149.3	143.7	153.9	163.2
Adjusted EBITDA/Adjusted operating revenue (%)	24.0	20.2	21.7	23.8	23.1

Table 1

Notting Hill Genesis--Key Statistics (cont.)

	--Year ends March 31 --				
(Mil. £)	2022a	2023e	2024bc	2025bc	2026bc
Debt/Non-sales adjusted EBITDA (x)	20.3	25.0	23.5	22.9	22.3
Non-sales adjusted EBITDA/interest coverage(x)	1.2	0.9	1.0	1.0	1.0

a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Table 2

Notting Hill Genesis--Ratings Score Snapshot

Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	2
Management and Governance	3
Financial risk profile	4
Financial performance	4
Debt profile	5
Liquidity	2

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
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- United Kingdom Outlook Revised To Stable From Negative On Moderating Fiscal Risks; 'AA/A-1+' Ratings Affirmed, April 21, 2023
- U.K. Social Housing Borrowing 2023: On Pause, March 28, 2023

- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings History: March 2023, March 27, 2023
- U.K. Social Housing Providers Set Their Sights On Cyber Risks, Dec. 16, 2022
- Non-U.S. Social Housing Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022
- Inflation To Erode The Performance Of U.K. Public Finance Sectors, Nov. 29, 2022
- 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
- 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
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings List

Ratings Affirmed	
Notting Hill Genesis	
Notting Hill Home Ownership Ltd.	
Issuer Credit Rating	A-/Stable/--
Notting Hill Genesis	
Senior Secured	A-
GenFinance II PLC	
Senior Secured	A-