FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Warsaw - 29 Jul 2020: Fitch Ratings has affirmed Notting Hill Genesis (NHG) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A'. The Outlooks are Stable.

The ratings reflect continuing high demand for social housing in London and the south-east of England, where NHG mainly operates, and continuing cash flow from rented properties. They also factor in NHG's secured cash flow from public funds and the control and regulation provided through the Regulator of Social Housing (RSH). As of 1 April 2020, NHG owned or managed more than 66,000 housing units, ranking it among the largest registered providers (RPs) in England.

The ratings also reflect NHG's moderate debt levels with stable debt metrics and satisfactory liquidity, which we expect to remain stable, despite a still sizable, albeit reduced, development plan to deliver more than 6,800 units (previously 12,500) within the next five years. The ratings also reflect a one-notch uplift that Fitch applies to NHG's Standalone Credit Profile (SCP), under Fitch's Government Related Entities (GRE) Criteria, and strength-of-linkage and incentive-to-support factors. The RSH continues to provide strong oversight.

The Stable Outlooks reflect Fitch's view that NHG will continue to show satisfactory performance, despite a weakened operating environment and increased challenges faced by RPs in England.

The recent outbreak of coronavirus and related government containment measures worldwide create an uncertain environment for RPs in the near term. While material changes in revenue and cost profiles are occurring across GREs in the UK, and are likely to continue in the coming weeks and months as economic activity suffers and government restrictions are maintained, we expect the social housing sector to remain strong. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in the social housing sector as a result of the virus outbreak for their severity and duration, and incorporate revised base- and rating-case qualitative and quantitative inputs based on expectations for future performance and assessment of key risks.

Fitch does not see any immediate rating impact from the pandemic on RPs of social housing, which are less affected than other Fitch-rated sectors. An increase in arrears may arise in the short term, as a result of the economic downturn. However, RPs have flexibility on the scope and timing of maintenance works to alleviate pressure on their short-term liquidity. The overall impact is lessened for RPs because a significant proportion of rental income within social lettings is funded by benefit payments that will continue.

KEY RATING DRIVERS

The following rating factors are reflected in NHG's SCP of 'a-':

Revenue Defensibility: 'Strong'

Fitch assesses revenue defensibility, which covers demand and pricing, as 'Strong' overall. Demand for social housing remains strong and changes to rents are unlikely to materially affect demand. The supportive regulatory regime aims to maintain compensation for essential public services. On the core operations RPs have limited revenue flexibility, as it is the UK government that determines social housing rent rises. Since April 2016, rents have been reduced 1% a year and then on 4 October 2017, it was announced that rents would return to consumer price index plus 1% for five years from 1 April 2020. However, due to the growing share of revenue from non-social housing activity, RPs have been collecting enough revenue to cover all costs.

Operating Risk: 'Strong'

Operating risk, which covers operating costs and resource management, is assessed as 'Strong' overall. NHG has well-identified cost drivers and low potential volatility in major items. NHG has material capex in its development plans in the medium term but has flexibility to scale back committed schemes, defer uncommitted schemes and to rent out housing units if not sold, all of which to some extent have been utilised. Additionally, in the event of financial stress, NHG can cut back discretionary expenditure or non-essential major works.

RPs in the UK have fared well in the coronavirus outbreak as they have begun preparations ahead of uncertainties around Brexit. RPs may need to delay development programmes, affecting their cash flow, and postpone funding due to market uncertainty. Isolation measures have affected the UK property market (decline in home viewings; people reconsidering plans to buy or sell), which is being monitored by the UK government with the stamp duty holiday recently introduced to stimulate the market. The construction industry has said that building companies face widespread insolvencies - affecting RPs - without government action. However, RPs have some near-term flexibility and will likely boost their liquidity as an additional buffer.

NHG has stress-tested and run multiple scenarios for its business plan. In general, throughout the stress-tested business plan interest cover and gearing covenants are met, albeit with decreased headroom. In some scenarios, where multiple risks materialise all at once, interest cover could be breached if no mitigating measures are taken, which we view as unlikely. We will also closely review the robustness of NHG's stress-testing relative to the ratings, including the impact of Brexit or the pandemic on the business plan, and assess NHG's flexibility to adapt to market conditions.

Financial Profile: 'Strong'

NHG has demonstrated sound financial performance despite the challenges that have affected the sector over recent years. Continued high demand for social and affordable housing, cost-efficiency measures and increasing diversification into non-core business should allow NHG to maintain sufficient revenue to service debt and cross-subsidise its core business.

We expect NHG's sound financial performance to continue, aided by the economies of scale achieved with the merger of Notting Hill Housing Trust and Genesis Housing Association Limited, and a reduced development plan. Profits from the disposal of private-sale units will be re-invested to continue to build and provide affordable social units. The share of non-social housing activity is expected to peak in financial year ending March 2021, at 37% of total turnover, versus 24% in FYE20. In the medium term, on average, 75% of the turnover will continue to be from social housing-related activities (lettings and sales). NHG's board and management follow a prudent approach to risk and debt. Debt will continue to increase to fund capex as outlined under NHG's development plan.

NHG developed more than 1,960 units in FY20 (FY19: 2,111) and in its investment plan it aims to develop more than 6,800 units over the next five years, split between 31% low-cost rental, 35% shared-ownership, 12% private rent and 22% private sale.

In its rating case, Fitch expects NHG's debt to increase to about GBP4.1 billion by FYE25 (about 3% annually) following investments (FYE20: GBP3.5 billion). However, in relation to Fitch-calculated EBITDA net debt is expected to return to around 12x by FYE22 (expected FYE20: 12.8x) after increasing to 14.6x in FYE19, despite lower revenue from sales and increased spending on fire and safety improvements in existing stock.

DERIVATION SUMMARY

Fitch rates social housing RPs in England using a bottom-up approach under its Revenue-Supported Rating Criteria and takes into account factors such as revenue defensibility, operating risks and financial profile. We incorporate public-support factors, notably the strong predictability of the RP's cash flow through direct and indirect government funding. Fitch also applies the GRE Criteria, under which status, ownership and control are assessed as 'Strong' for NHG. Support track record and expectations is assessed as 'Moderate' and the socio-political implications of default are assessed as 'Moderate' while the financial implications of default are assessed as 'Weak'. This gives a total score of 12.5, leading to a bottom-up + 1 under our notching guideline, and the final IDR of 'A'. As a consequence, RPs' ratings do not automatically move in line with those of the UK sovereign.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Improvement of net adjusted debt/EBIDTA on a sustained basis to below 10x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Increased volatility in operating revenue as a result of higher exposure to non-core activities and a significant increase in gearing and net adjusted debt/ EBITDA to above 12x on a sustained basis.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

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

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The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

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

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 13 Nov 2019)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

GenFinance II PLC	EU Issued
Notting Hill Genesis	EU Issued

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