S&P Global
Ratings

RatingsDirect®

Notting Hill Genesis

August 25, 2022

PRIMARY CONTACT

Abril A Canizares
London
44-20-7176-0161
abril.canizares
@spglobal.com

SECONDARY CONTACT

Karin Erlander
London
44-20-7176-3584
karin.erlander
@spglobal.com

This report does not constitute a rating action.

Credit Highlights

Overview

Enterprise profile	Financial profile
Strong market fundamentals in its area of operations balance volatility from exposure to sales activities. - Large volume of units, which provides greater flexibility to withstand external shocks. - Strong demand for Notting Hill Genesis (NHG) housing stock as it operates predominantly in London. - Modest exposure to sales risk that we expect would average around 20% of total revenues after including joint ventures.	A strong liquidity position balances pressures on its debt profile. - Large investments in existing stock and high inflation should see S&P Global Ratings-adjusted EBITDA margins stay close to 24% through fiscal years 2023-2025. - Funding the development of new homes will modestly increase debt as spending will be partly funded by revenues from disposals of fixed assets and grants. - A robust liquidity position is supported by strong access to the capital markets.

Outlook

The stable outlook reflects our expectation that Notting Hill Genesis has sufficient headroom to absorb large investments on its existing stock while executing its development strategy.

Downside scenario

We could lower the rating if management's strategy around market sales turns more aggressive, or if the group cannot maintain a solid performance by managing difficulties stemming from the increases in its cost base, resulting in S&P Global Ratings-adjusted EBITDA margins dipping below 20% and leading to higher-than-anticipated increases in debt and weaker interest coverage.

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

Upside scenario

We could raise the rating if management's strategy led to a strengthening in the group's EBITDA margins above 30% on a sustained basis, while improving the group's debt metrics.

Rationale

Notting Hill Genesis' (NHG) areas of operations are predominantly focused on London, where demand for social housing is high. Its enterprise profile is further supported by the large gap between NHG's general-needs average rent and market rent, which we estimate is around 52%. This has resulted in average vacancy rates of around 1.7% over the last three years, which is on par with those of the overall sector. The large asset base, which as of the fiscal year ending March 31, 2022 (FY2022) reached 67,500 units, provides the group with greater resilience to withstand external shocks.

We estimate that through FY2025 exposure to sales activities will remain modest and we therefore expect the group's performance to benefit from a more predictable revenue stream from social housing lettings. Through fiscal years 2023-2025 we estimate revenues from sales, including those derived via joint ventures, will average around 20% of total revenues, reducing from 39% and 31% in FY2021 and F20Y22, when the group conducted large bulk sales to private investors. The group made the reduction of unsold homes one of its key targets in its strategic plan and, to this end, NHG has been conducting bulk sales since FY2019. The group has contained development-for-sales and has scaled down its exposure to this riskier activity.

In our view, NHG's management has sufficient expertise to address short- to medium-term difficulties by adapting its business plan to market conditions. We expect management to prudently tackle challenges on the expenditure side given the high inflationary environment. We note the announcement of CEO Katie Davies' departure, but do not expect any meaningful changes to the group's risk appetite as demonstrated by the most recent board-approved business plan. We regard risk management as prudent with very low reliance on asset disposals to maintain robust interest cover. The group's liquidity benefits from the availability of short-term facilities, and almost all outstanding debt as of FY2022 was at fixed interest rates and so avoids pressure from interest rate hikes. In addition, the group continues to improve its ESG reporting and alignment with sustainability principles and issued its first Green Bond in June 2021 at a favorable coupon rate of 2.08%.

The May 2022 board-approved group strategy accommodates a much larger spend on existing homes, which we expect to average around 12% of social housing costs compared to around 5% previously. The group's focus is on completing fire remediation works required on its properties and which, for fiscal years 2023-2025, will average around 35% of total planned capitalized repairs. The large increase in capitalized repairs also reflects investments in energy efficiency. The group targets for all its stock to be rated EPC of above C. There is also still a backlog from pandemic-induced investment delays.

We therefore estimate that larger investments in existing stock will add pressure to its S&P Global Ratings-adjusted EBITDA margins, and that these will average close to 24% through FY2025. In the current fiscal year, ending March 2023, we estimate that S&P Global Ratings-adjusted EBITDA margin will dip to 21% as the high inflationary environment results in the cost base growing more than rental revenues. We estimate that the group's margins will recover in FY2024 and FY2025 as the gap between cost increases and revenue growth narrows.

Assuming the development of new homes will be partly debt-funded, we anticipate that debt will continue modestly increasing through FY2025. This, combined with expected lower adjusted EBITDA margins, adds pressure to NHG's debt metrics mainly in FY2023 when we expect that non-sales adjusted EBITDA interest cover will be slightly below 1x. Revenues from disposals of fixed assets and from secured grants provide additional sources for funding planned capital expenditure. The group's strategy still targets annual development of 1,400 units, a target set in fiscal year 2021 that was scaled down from a previously planned 2,700 units per year from the time of the merger in 2018. The development program is focused on delivering new homes in London in an EPC band of higher than C.

We believe there is a moderately high likelihood that NHG would receive timely extraordinary government support in case of financial distress. This provides one notch of uplift from the stand-alone credit profile. As one of the Regulator of Social Housing's (RSH's) key goals is to maintain lender confidence and low funding costs across the sector, we believe it is likely that the RSH would step in to try to prevent a default in the sector. We base this view on previous records of the RSH mediating mergers or arranging liquidity support from other registered providers in cases of financial distress, and we think this would also apply to NHG.

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

Liquidity

We forecast NHG's liquidity position will remain very strong over the next 12 months. We estimate that NHG's sources will cover uses by about 2.3x. While we expect that liquidity buffers will reduce as the group progresses with its investments, we expect its liquidity position to remain very strong. This is further supported by our view that NHG will continue to have strong access to the debt capital markets.

Sources of liquidity include:

- Cash flow from operations, adding back the noncash cost of sales of close to £262 million;
- Cash balances of about £92 million;
- Undrawn committed bank lines of about £917 million;
- Fixed asset sales of close to £64 million; and
- Other cash inflows of around £40 million.

Uses of liquidity include:

- Capital expenditure and development spend of close to £446 million; and
- Interest and principal repayments of about £149 million.

Environmental, Social, And Governance

NHG’s performance on environmental, social, and governance (ESG) indicators is broadly in line with its sector peers. We think that social housing providers face social risks stemming from higher inflation and slower economic growth. However, the focus on the core business of affordable social housing, which provides predictable and relatively stable earnings, should help mitigate some of these risks, as is the case for NHG.

We think that environmental factors due to enhanced building and fire safety standards and a government agenda to improve energy efficiency in the sector could weaken social housing providers' profitability and put further pressure on the debt service capacity. In the near to medium term, this focus on increasing investments in existing homes could weigh on NHG’s performance. We assess the group's current asset quality to be on a par with its peers.

Key Statistics

Notting Hill Genesis -- Key Statistics

	-- Year ending March 31--				
Mil. £	**2021a**	**2022e**	**2023bc**	**2024bc**	**2025bc**
Number of units owned or managed	66,537	67,541	68,159	68,537	67,950
Adjusted operating revenue	896	822	726	762	851
Adjusted EBITDA	248	195	155	178	202

Non-sales adjusted EBITDA	174	163	141	169	187
Capital expense	245	346	383	492	434
Debt	3,379	3,353	3,419	3,656	3,664
Interest expense	143	143	146	151	154
Adjusted EBITDA/Adjusted operating revenue (%)	27.7	23.8	21.4	23.4	23.8
Debt/Non-sales adjusted EBITDA (x)	19.4	20.5	24.3	21.6	19.6
Non-sales adjusted EBITDA/interest coverage(x)	1.2	1.1	1.0	1.1	1.2

a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Rating Component Scores

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	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

- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022
- Regulatory Framework And Systemic Support Assessments For Nonprofit Social Housing Providers, Aug. 15, 2022
- Non-U.S. Social Housing Providers Ratings Risk Indicators, July 27, 2022
- Non-U.S. Social Housing Providers Ratings Score Snapshot, July 27, 2022
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 22, 2022
- U.K. Social Housing Sector Borrowing Needs To Rise To Fund Investment In New Homes, March 31, 2022
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021

Ratings Detail (as of August 25, 2022)*

Notting Hill Genesis	
Issuer Credit Rating	A-/Stable/--
Senior Secured	A-
Issuer Credit Ratings History	
05-Jun-2019	A-/Stable/--
27-Jul-2018	A/Negative/--
03-Apr-2018	A+/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.