Research Update:

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

June 25, 2020

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Overview

- Social housing provider Notting Hill Genesis' (NHG) very strong liquidity position should help it ride out fluctuations in the housing market driven by the combination of the ongoing COVID-19 pandemic and the approaching end of the post-Brexit transition period.
- NHG's ability to raise rents and develop lettings-based homes will support its financial performance.
- We are affirming our long-term issuer credit rating on NHG at 'A-'.
- The stable outlook indicates that NHG will manage its unsold homes and future sales in a risk-appropriate manner, such that financial performance improves in line with our base case.

Rating Action

On June 25, 2020, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on U.K.-based social housing provider Notting Hill Genesis (NHG). The outlook is stable.

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

We affirmed our 'A-' issue ratings on all five bonds issued by NHG and the £250 million bond, due 2039, issued by the treasury vehicle, GenFinance II PLC.

Rationale

We affirmed the rating as we consider that NHG is well-positioned to navigate the uncertainty caused by the COVID-19 pandemic. NHG's liquidity position remains strong and should support its development aspirations--we expect NHG to develop around 3,100 homes by March 31, 2023. We anticipate that NHG will raise £250 million in additional funding in the financial year (FY) ending March 31, 2021. This will underpin NHG's already robust liquidity position.

The protracted Brexit talks, combined with the arrival of COVID-19, caused the housing market to falter, hampering NHG's ability to achieve all of its planned sales in FY2020. Consequently, at the end of FY2020, NHG had around 600 unsold homes. It now plans to sell these in the years to FY2023. In addition to these unsold homes, NHG has converted around 300 unsold for sale homes to rental properties. They were made available at market or London Living rent in FY2020.

In our base case, we assume that NHG will suffer some rental losses in its general needs, market rent, and student accommodation operations because of the COVID-19 pandemic. As such, we expect S&P Global Ratings-adjusted EBITDA margins to fall to 24% in FY2021, from nearly 27% the year before. That said, we expect stress to be contained to FY2021. A more-favorable rent policy, allowing increases of consumer price index (CPI) plus 1%, combined with a growing asset base, should see margins trend toward 30% by FY2023.

As for other registered English social housing associations, we believe there is a moderately high likelihood that NHG would receive extraordinary support in case of financial distress. This provides a one-notch uplift from the SACP. NHG's primary purpose is to provide affordable homes, supporting important policy objectives of the U.K. government. We consider that the Regulator of Social Housing (RSH), a government agency, regulates NHG to promote a viable, efficient, and well-governed social housing sector, and maintain lender confidence and low funding costs across the sector. It is therefore our view that the RSH would step in to prevent a default in the sector, based on its record of being willing and able to provide extraordinary support on a timely basis.

NHG's sales exposure remains high compared with peers, and we expect sales proceeds to account for around 27% on average between FY2021 and FY2023. That said, NHG generates most of its revenue from its core social housing activities. Therefore, we consider that our rating on NHG benefits from the characteristics of this low-risk industry, namely, its anticyclicality and its high barriers to entry.

We assess NHG's economic fundamentals as very strong because most of its operations focus on London; this supports our rating on NHG. London's population growth of 0.8% is not only higher than the national average of 0.5%, it's the strongest in the U.K.

Furthermore, NHG's social rent levels are below 50% of the average market rent levels in the capital. This steep discount, combined with high population growth in its areas of operations, supports demand for NHG's operations.

Despite the increased arrears caused by COVID-19, NHG's quality of assets and its operational performance are still rating strengths. Gross arrears, according to unaudited FY2020 figures, increased slightly to 8.4%, from 8% in the year before. That said, voids have remained low and flat at 1.4% over the past year. Furthermore, NHG has a large asset base of just under 65,000 units, which will help it to withstand shocks to the sector.

We expect NHG to develop around 3,100 units in the years to FY2023, of which around 1,000 will be for affordable rent, 930 for shared ownership, 530 for market rent, and the remainder for outright sale. Aside from new development, NHG also has around 600 unsold homes, which it will seek to sell by FY2023.

Despite weaker margins on sales, we expect that post-COVID-19, the ability to increase rents, combined with a growing lettings-based business, will help NHG to improve its financial performance. We expect adjusted EBITDA margins to increase to just under 30% by FY2023. Over the same period, NHG is likely to sell around 2,000 homes, split evenly between outright and shared ownership sales. NHG's large sales exposure could make its performance more volatile and weigh on margins because sales are associated with a poorer quality of earnings.

Nevertheless, NHG's sales activities, combined with its growing rental income base, will help strengthen EBITDA, which supports its debt profile. Unaudited numbers show debt of £3.5 billion for FY2020. We expect debt to increase to £3.7 billion by FY2023 as NHG debt-funds its affordable development. If adjusted EBITDA expands more quickly, as expected, NHG could still see an improvement in debt-to-EBITDA, to 16.7x in FY2023 from 19.2x in FY2021. That said, we anticipate that such an improvement in EBITDA would be underpinned by the sale of its unsold homes, rather than by a marked improvement in NHG's rental earnings.

EBITDA interest coverage should also strengthen in line with performance. FY2021's weaker EBITDA will see interest coverage fall to 1.2x, at a group level. Once the effect of COVID-19 has waned, we expect EBITDA to grow. This should allow interest coverage to strengthen to 1.5x. We expect EBITDA generated from lettings alone to improve in a similar fashion, to 1.4x in FY2023 from 1.3x in FY2020. NHG's nonsales EBITDA coverage is supported by its general needs business and by its profitable market rent segment.

Liquidity

We regard NHG's liquidity position as very strong because of its large undrawn committed facilities and strong access to external liquidity. It issues regularly in the debt capital markets.

In our base case, we estimate sources of funds will cover uses by about 1.7x over the next 12 months.

Sources of liquidity will include:

- Adjusted EBITDA as a cash flow proxy (net of cost of sales relating to unsold homes) of close to £310 million;
- Cash and cash equivalents of £137 million;
- Proceeds from asset sales of around 39 million; and
- Available funds under undrawn committed facilities of close to £478 million.

Uses of liquidity will include:

- Capital expenditure of about £203 million;
- Interest and principal repayments of close to £361 million; and
- Grant repayment of around £10 million.

We view NHG's access to external liquidity as strong. Notting Hill Housing and Genesis Housing have demonstrated their ability to issue several bonds separately over the past few years and the newly amalgamated entity made its first £250 million 10-year maturity bond issuance in January 2019.

Outlook

The stable outlook indicates that we expect NHG to manage the sale of unsold and new homes in a risk-appropriate manner, such that volatility from these sales does not impede an improvement in financial performance.

Downside scenario

We could lower the ratings on NHG if its sales operations, particularly its handling of unsold stock, began to materially weaken its financial profile. Delays in sales, both of unsold or new stock, would subdue EBITDA growth, which could weigh on its debt servicing metrics.

We could also lower the rating should NHG not recover in line with our forecasts for the period after the pandemic, or should the consequences of Brexit weigh on NHG's operations, in particular, its sales.

Furthermore, if we considered NHG had become less likely to receive extraordinary government support through the RSH, we could also lower the rating.

Upside scenario

We could raise the ratings if we observed an improvement in financial performance, combined with contained exposure to sales activity. Under such a scenario, we would expect NHG to display adjusted EBITDA margins above 30% on a consistent basis, driven by a strengthening in performance at its traditional lettings business. This would help to significantly improve its EBITDA interest coverage, and maintain its debt-to-adjusted EBITDA ratio well below 20x.

Ratings Score Snapshot

Table 1

Notting Hill Genesis Ratings Score Snapshot

Industry risk	2
Economic fundamentals and market dependencies	2
Strategy and management	3
Asset quality and operational performance	1
Enterprise profile	3
Financial performance	5
Debt profile	3
Liquidity	2
Financial policies	3
Financial profile	4

S&P Global Ratings bases its ratings on non-profit social housing providers on the eight main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, summarizes how the eight factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating. For social housing providers generating more than a third of its consolidated revenues from open market sales, we also refer to the "Key Credit Factors For The Homebuilder And Real Estate Developer Industry."

Key Statistics

Table 2

Notting Hill Genesis Key Statistics

	--Year ended March 31--				
(Mil. £)	**2019a**	**2020e**	**2021bc**	**2022bc**	**2023bc**
Number of units owned or managed	63,475	64,854	65,609	66,207	66,634
Revenue*	659.4	721.2	762.6	856.9	750.0

Table 2

Notting Hill Genesis Key Statistics (cont.)

	--Year ended March 31--				
(Mil. £)	2019a	2020e	2021bc	2022bc	2023bc
Share of revenue from sales activities (%)	20.1	24.8	29.9	31.9	19.8
EBITDA*§	164.5	192.7	182.2	225.9	220.1
EBITDA/revenue *§(%)	24.9	26.7	23.9	26.4	29.4
Capital expense†	356.5	325.1	188.9	273.1	333.2
Debt	3,471.0	3,486.5	3,497.4	3,484.2	3,666.3
Debt/EBITDA *§(x)	21.1	18.1	19.2	15.4	16.7
Interest expense†	140.5	146.9	146.7	146.6	150.2
EBITDA/interest coverage*§†(x)	1.2	1.3	1.2	1.5	1.5
Cash and liquid assets	150.6	136.4	139.1	100.0	100.0

*Adjusted for grant amortization. §Adjusted for capitalized repairs. †Including capitalized interest. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, Dec. 17, 2014
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 24, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020
- U.K. Social Housing Ratings History: February 2020, March 3, 2020
- Why Most Rated U.K. Social Housing Providers Are At Home In The 'A' Category, Dec. 3, 2019
- Global Social Housing Ratings Score Snapshot: December 2019, Dec. 2, 2019
- Global Social Housing Risk Indicators: December 2019, Dec. 2, 2019

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-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.