FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Notting Hill Genesis to 'A-'; Outlook Stable

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Fitch Ratings - London - 18 Oct 2024: Fitch Ratings has downgraded Notting Hill Genesis's (NHG) Long-Term Issuer Default Rating (IDR) to 'A-' from 'A' and Short-Term IDR to 'F1' from 'F1+'. The Outlook on the Long-Term IDR is Stable

The downgrade reflects NHG's worsening financial leverage metrics.

Fitch views NHG as a government-related entity (GRE) of the United Kingdom (AA-/Stable). We have 'Strong expectations' of support from the state for NHG. Combined with a Standalone Credit Profile (SCP) assessed at 'bbb+', which is four notches below the sovereign, this leads to a one-notch uplift for the IDR. Continuing high demand for social and affordable housing and ongoing cash flow from rented properties continues to support NHG's credit, despite the challenging economic environment

KEY RATING DRIVERS

Support Score Assessment 'Strong expectations'

We have 'Strong expectations' of extraordinary support for NHG in case of need, reflecting a support score of 20 (out of a maximum 60) under Fitch's GRE criteria. This reflects a combination of responsibility to support and incentive to support factors assessment as below

Responsibility to Support

Decision Making and Oversight 'Strong'

NHG is a private, not-for-profit registered provider (RP) of social housing (SH) in the UK, and as such it is not under the ownership of the UK government due to its structure and status. In strict terms there is no legal owner, with all surpluses reinvested to provide SH. We consider the regulatory framework for English SH as having a robust legal basis, and the overseeing Regulator of Social Housing, as maintaining sound control and tight monitoring of RPs. The regulator's history of oversight and (non-financial) intervention in (rare) cases of distress is a key factor behind the sector's solidity.

Precedents of Support 'Strong'

NHG receives ongoing financial support through grants from Homes England and the Greater London Authority for social, affordable and shared ownership development. This is to support additional subsidised housing, not to finance debt or prevent default.

Fitch takes into account the support mechanisms the issuer can benefit from, or has benefited from, via the sponsor, the UK. Policy influence is supportive of the financial stability of RPs. Regulatory restrictions on government support are unlikely to prevent timely intervention in exceptional circumstances.

Incentives to Support

Preservation of Government Policy Role 'Strong'

SH is a key public service. There would be no immediate impact on the service in case of default, but there would be a medium-term impact on the provision of service as RPs rely on external financing to finance maintenance capex and new investments. In the unlikely event of financial default, other RPs could act as substitutes, with only temporary disruption to the service offered by the RP and diminished medium-term service provision due to reduced financial resilience and access to finance.

Contagion Risk 'N/A'

Default would have a minimal impact on the availability or cost of domestic financing for the UK. Fitch considers that if a default occurred, it would be treated as an isolated case of mismanagement or viability concerns Consequently, this should not affect the sector as a whole.

Standalone Credit Profile

NHG's 'bbb+' SCP reflects the combination of a 'Stronger' risk profile and a financial profile assessed at the upper-end of the 'bb' category, with forecast leverage expected to average 13.6x during the five years to the financial year ending March 2029 (FY29) under our rating case (FY24: 17.4x).

Risk Profile: 'Stronger'

Fitch assesses NHG's risk profile at 'Stronger', reflecting the combination of assessments:

Revenue Risk: 'Stronger'

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. NHG is one of England's major RPs, operating in all of London's boroughs focusing on Barnet, Brent, Ealing, Hounslow, Lambeth, Westminster, Camden, Hammersmith and Fulham, and Kensington and Chelsea. It has narrowed its operational area to key strategic regions by exiting several local authorities after a merger in 2018. Occupancy remains high at 99.3% for FY24 (FY23: 99.2%), while collection rate remained stable at 98.8% and arrears at 5.5% (FY23: 5.3%). Re-let days reduced to 38.8 days in FY24 from 47.2 days in FY23.

The UK government sets the threshold for annual social rent increases through the Rent Standard. However, NHG has flexibility in pricing its non-social lettings activities, which it uses to cross-subsidise its core business. Over half of NHG's managed homes are general needs properties, charged at social or affordable rent levels, offering stable cash flow in a counter-cyclical environment. Fitch expects rent increases to return to CPI+1% from FY24, following the 7% cap that was applied in April 2023 for one year.

Expenditure Risk: 'Stronger'

Fitch assess operating costs as 'Stronger' for NHG. It has well-identified cost drivers and low potential volatility in major items. Staff costs are the most rigid cost item and account for only 18% of cash opex, in line with some of its strongest peers. There are no material supply constraints on labour or resources.

The sector faces challenges from fire safety regulations, government decarbonisation requirements, maintenance backlogs post-pandemic, and maladministration findings on damp and mould. NHG has invested GBP40 million in improving and maintaining its existing stock (not including mechanical and engineering projects) and plans to invest a further GBP770 million over 10 years in its existing stock, aiming for GBP35 million in annual efficiency savings by FY27 to offset inflationary pressures.

In FY24, NHG recognised GBP102.2 million in exceptional items due to updated government regulations, including GBP21.2 million for derecognition of a financial asset, GBP51.6 million for building safety liabilities, and GBP29.4 million for impairment of stock and housing properties. NHG projects total building safety costs over the next seven years of GBP173 million, net of potential recoveries.

NHG completed 814 homes during FY24 (FY23: 459) including 243 social and affordable and 152 shared ownership homes. NHG has reduced its development plan to 500 new homes per year over the next 10 years, and has rationalised its land bank.

Liabilities and Liquidity Risk: 'Stronger'

NHG has significant access to finance across the banking sector and debt capital markets. It holds eight public outstanding public bonds totalling GBP 2.3 billion. The overall debt portfolio is about GBP3.6 billion and comprises bonds, term loans and revolving credit facilities across several lenders. As of March 2024, 94% of its drawn debt was fixed-rate, limiting exposure to interest rate risk. NHG generally only borrows and lends in sterling, which minimises currency risk. If it does borrow in foreign currency, all associated cash flows are hedged to mitigate the risk. The weighted average life of outstanding borrowing is around 13 years.

At 31 March 2024, NHG had cash and undrawn facilities available of around GBP863.2 million. This comprised GBP768 million undrawn committed revolving credit facilities and GBP95.2 million in cash. It has over 17,200 unencumbered properties, with a security value of GBP2.7 billion. It expects the reduced development programme to deliver an additional 7,500 units over 10 years, which could be securitised if the need for additional financing arises. This is more than sufficient to cover NHG's forecast borrowing requirements.

Financial Profile

Fitch assesses NHG's financial profile at 'bb'. Performance has deteriorated in recent years due to sector challenges (including building safety expenditures, decarbonisation requirements and reinvestment in stock to meet government regulations etc). However, NHG has made strategic decisions to limit development and dispose of non-core stock to recover financial resilience in the medium term.

Fitch stresses management's expectations to achieve its rating-case scenario. We expect NHG's operating revenue to average about GBP733 million between FY25 and FY29, with EBITDA averaging GBP241 million a year. As a result of the lower capex plan and stock rationalisation plan, we expect net adjusted debt to EBITDA to average around 13.6x during the rating case, in line with high 'bbb' SCP category peers. We expect leverage to improve over the rating case, but this will hinge on asset sales and achieving the efficiency savings outlined in the plan. Reduced development limits fluctuations in cash flow but also constrains EBITDA generation, which impacts leverage metrics.

In FY24, NHG reported operating revenue of GBP706 million (FY23: GBP723 million), with EBITDA of GBP200 million (FY23: GBP190 million). Net debt at end-FY24 was GBP3.5 billion (FY23: GBP3.2 billion).

Additional Risk Factors Considerations

Asymmetric risk attributes are all assessed as 'Neutral' due to a strong regulatory framework, transparent reporting of information and a risk averse debt structure. Debt is mostly fixed rate and vanilla in nature (sterling bonds and bank debt). Governance and management are assessed by the regulator and most RPs have compliant ratings of either G1 or G2. They operate under English law, which is considered strong, and their Country Ceiling is 'AAA'. Information quality is strong, with external publications internally and externally audited.

Derivation Summary

NHG's rating is driven by its SCP, which we have revised to 'bbb+' from 'a-'. NHG's 'bbb+' SCP is driven by a 'Stronger' risk profile and 'bb' financial profile, and comparison with peers. We view NHG as a GRE in the UK, with a support score of 20 points. This results in a bottom-up approach, with a one-notch uplift from the SCP to the 'A-' Long-Term IDR.

Short-Term Ratings

NHG's Short-Term IDR is the higher of two possible outcomes, 'F1', as a result of the 'A-' Long-Term IDR and strong liquidity metrics.

Debt Ratings

Fitch rates NHG's debt issuances, which are unconditional, unsubordinated, and rank pari-passu with all other debt in the group, in line with the IDR at 'A-' for senior secured ratings. Fitch rates NHG's GBP2 billion EMTN programme under these debt levels.

Issuer Profile

As of 31 March 2024, NHG owned or managed more than 67,636 housing units, ranking it among the largest RPs in England and a constituent member of the G15, the biggest RPs in London.

KEY ASSUMPTIONS

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on FY20-FY24 historical figures and FY25-FY29 scenario assumptions.

RATING SENSITIVITIES

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

Sustained deterioration of net debt/EBITDA above 18x on a sustained basis, 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 an upgrade.

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-	Downgrade	A
Notting Hill Genesis	LT IDR	A- Rating Outlook Stable	Downgrade	A Rating Outlook Negative
	ST IDR	F1	Downgrade	F1+
	LC LT IDR	A- Rating Outlook Stable	Downgrade	A Rating Outlook Negative

	LC ST IDR	F1	Downgrade	F1+
senior secured	LT	A-	Downgrade	A

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Public Policy Revenue-Supported Entities Rating Criteria (pub. 12 Jan 2024) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub. 09 Jul 2024)

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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