S&P Global Ratings

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Notting Hill Genesis

March 14, 2023

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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.	A strong liquidity position balances pressures on the debt profile.
Large volume of units, which provides greater flexibility to withstand external shocks.	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.
Strong demand for Notting Hill Genesis (NHG) housing stock as it operates predominantly in London.	Solid interest cover and stable debt levels supported by robust EBITDA margins and scaled-down development plans.
Modest exposure to sales risk that we expect would remain below 20% of total revenue after including exposure through joint ventures.	Strong access to the capital markets supports a robust liquidity position.

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

NHG's large asset base, comprising over 67,500 homes and operating predominantly in high-demand London areas, helps the group to withstand external shocks, generating a stable stream of revenue from traditional business activities. NHG continues to focus on its social mission, reflected in the large gap between NHG's general needs average rent and market rent, which we estimate to be about 52%. The group's enterprise profile is further supported by average vacancy rates of about 1.6% over the past three years, which are on par with those of the overall sector.

We estimate that through fiscal year ending March 31, 2025, 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 revenue from sales, including those derived via joint ventures, will be contained below 20% of total revenue, reducing from 39% and 31% in fiscals 2021 and 2022, when the group conducted large bulk sales to private investors. The group made significant progress on its target of reducing unsold homes, by way of conducting bulk sales since fiscal 2019. 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, evidenced by strategically dealing with accumulated unsold stock and the timely scaling back of development plans to stabilize debt levels. We expect management to prudently handle pressures arising from the high inflationary environment affecting the cost base, and to continue investments, especially on fire safety spends, which we estimate will peak in the coming years. NHG recently appointed Patrick Franco as the new group CEO, and we do not expect any material change in the group's strategic planning, as demonstrated by the most recent business plan. We regard the group's risk management as prudent, with robust stress testing and timely decision making leading to successful mitigation of potential risks, while keeping metrics stable. The group's liquidity remains robust as, in our view, NHG has retained strong access to the capital markets. In addition, the group continues to improve its environmental, social, and governance (ESG) reporting and alignment with sustainability principles, and it issued its first Green Bond in June 2021.

NHG's business strategy counterbalances the increased investments in existing homes by further scaling down the development plan. NHG is prioritizing investments required in fire-safety remediation works on its existing homes, because it has multiple high-rise buildings in London, and we expect these costs to constitute about one-third of the total planned capitalized repairs over the forecast horizon. The group's aim to invest in energy efficiency is also reflected in a large increase in capitalized repairs, working toward bringing all stock to a minimum of EPC C level. We understand that nearly 80% of the total stock portfolio is currently rated EPC C or higher.

We forecast NHG's adjusted EBITDA margins to comfortably remain above 20% through fiscal 2025, supported by robust margins on traditional business activities and mainly in-house maintenance to help tackle challenges arising from cost and labor shortages. We estimate that the gap between cost increases and revenue growth will narrow, to further accommodate the rising investment in existing stock.

We expect debt levels to stabilize because we do not anticipate NHG raising significant new funding in fiscal 2023, as the scaled down development program is funded primarily through existing cash and revenue generated from bulk sales and disposals of fixed assets. This has resulted in an improvement of the interest cover and more-favorable debt metrics.

NHG completed the sale of seven extra care schemes to Housing 21 in early 2023, generating proceeds of £61 million. An additional scheme will likely be sold to Housing 21 in March 2023, bringing further £15 million in revenues, which will moderate the group’s debt needed to fund development of new homes.

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 2.1x. 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 £232 million;
- Cash balances of about £44 million;
- Undrawn committed bank lines of about £902 million;
- Fixed asset sales of close to £100 million; and
- Other cash inflows totaling about £62 million.

Uses of liquidity include:

- Capital expenditure and development spend of close to £469 million; and
- Interest and principal repayments of about £171 million.

Environmental, Social, And Governance

We think that U.K.-based social housing providers are exposed to elevated environmental and social risks that relate to affordability of services and increased investment in existing homes.

These include inflationary pressures along with the need to enhance the quality of social housing stock, in particular around fire and building safety, as well as the government's environmental agenda to achieve energy efficiency and net-zero carbon.

We think these risks apply to NHG in line with the sector. We assess the group's current asset quality to be comparatively better than the sector because the level of stock compliant above EPC C is close to 80% of the total stock. 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	2022a	2023bc	2024bc	2025bc
Number of units owned or managed	66,537	67,691	67,484	67,901	68,253
Adjusted operating revenue	896.2	822.5	709.6	725.5	797.9
Adjusted EBITDA	248.0	197.0	179.9	165.1	202.0
Non-sales adjusted EBITDA	174.4	165.0	159.2	154.7	182.1
Capital expense	244.7	215.9	341.9	468.4	547.5
Debt	3,379.3	3,352.5	3,328.5	3,547.2	3,873.0
Interest expense	143.1	143.1	135.5	139.7	150.9
Adjusted EBITDA/Adjusted operating revenue (%)	27.7	24.0	25.4	22.8	25.3
Debt/Non-sales adjusted EBITDA (x)	19.4	20.3	20.9	22.9	21.3
Non-sales adjusted EBITDA/interest coverage(x)	1.2	1.2	1.2	1.1	1.2

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

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

- 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
- Bulletin: Cap On Rent Increases Is Consistent With Our Base Case For English Social Housing Providers, Nov. 17, 2022
- United Kingdom, Oct. 24, 2022
- The U.K. Social Housing Sector Now Displays A More Pronounced Negative Bias In Its Creditworthiness, Oct. 11, 2022
- United Kingdom Outlook Revised To Negative On Rising Fiscal Risks; 'AA/A-1+' Ratings Affirmed, Sept. 30, 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
- Non-U.S. Social Housing Providers Ratings History: July 2022, July 27, 2022
- Non-U.S. Social Housing Providers Ratings Score Snapshot: July 2022, July 27, 2022
- Non-U.S. Social Housing Providers Ratings Risk Indicators: July 2022, July 27, 2022
- U.K. Social Housing Sector Borrowing Needs To Rise To Fund Investment In New Homes, March 31, 2022
- Global Regulatory Framework Report Card: Public And Nonprofit Social Housing Providers, June 8, 2021
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020

Ratings Detail (as of March 14, 2023)*

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.

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