FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Outlook on Notting Hill Genesis to Negative; Affirms at 'A'

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Fitch Ratings - London - 31 Oct 2022: Fitch Ratings has revised the Outlook on Notting Hill Genesis's (NHG) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) to Negative from Stable and affirmed the IDRs at 'A'.

The ratings reflect continuing high demand for social housing (SH) in London and south-east England, NHGs' primary area of operation, 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 by the Regulator of Social Housing (RSH). Fitch has seen a weakening in financial metrics through NHGs rating case, which has led to reduced headroom, and the revision of the Outlook to Negative. NHG's Standalone Credit Profile (SCP) is assessed at 'a-'.

KEY RATING DRIVERS

Status, Ownership and Control: 'Stronger'

NHG is a private, not-for-profit, registered provider (RP) of 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 it has no legal owner). We view the regulatory framework for English SH as having a robust legal basis, and the RSH 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. In the event of financial distress, we expect a transfer of assets and liabilities to another RP within the sector under the direction of the RSH.

Support Track Record: 'Stronger'

NHG receives financial support through grants from Homes England (HE) and the Greater London Authority (GLA) at varying levels for social and affordable development. This is on an ongoing basis to support development, not to finance debt or prevent default. The regulator assesses governance and financial stability every 18-36 months, dependent on an RP's size, to assess need for intervention, and NHG's current regulatory judgement is fully compliant at G1/V2, recognising the strong development programme with stable governance

Socio-Political Implications of Default: 'Stronger'

In the unlikely event of financial default, other RPs can act as substitutes with only minor or temporary disruption to the service offered by NHG. NHG's development plan may have to be scaled down to adapt to its new financing capacity, which limits its ability to provide housing in general.

Financial Implications of Default: 'Weaker'

Default would have a minimal impact on either the availability or cost of domestic financing of other RPs. Fitch believes that a default would be treated as an isolated case of mismanagement or viability issues and should therefore not affect the sector.

Standalone Credit Profile

Revenue Defensibility:

Fitch assesses revenue defensibility, which covers demand and pricing, as 'Stronger'. Demand for SH remains strong and changes to rents are unlikely to materially affect demand. The supportive regulatory regime aims to maintain compensation for essential public services at sufficient levels to cover operating expenditure and debt servicing.

This assessment considers the impact of any outcome from the rent cap consultation currently outstanding to allow for solvency of NHG. RPs have limited revenue flexibility, as the UK government determines SH rent rises for core assets. Core social rents are currently able to increase CPI +1% per year, but are likely to subject to an additional cap as a result of the ongoing consultation.

Operating Risk:

Operating risk, which covers operating costs and resource management, is assessed as 'Stronger'. NHG has well-identified cost drivers and low potential volatility of major items. It 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 discretionary expenditure or non-essential major works.

NHG continues to face material fire-safety works costs, expected to be more than GBP100 million over the next five years. We also expect significant spending to meet environmental sustainability requirements in the medium and long term, which is factored into NHG's long-term financial forecasts.

Brexit has had an impact on the sector as a whole, with fewer maintenance workers available, and shortages and price increases of materials. This has been coupled with a general inflationary environment caused by global events that has affected all sectors. We expect this to lead to higher operating costs across the sector, which has been factored into our financial assessment.

Financial Profile:

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 stable financial performance to continue, as 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-SH activity is expected to reduce but still remain a key feature of NHG. In the medium term, on average, 80% of turnover will continue to be from SH-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, but there will also be some strategic sales used to reinvest.

NHG developed almost 1,250 units in the financial year ending 31 March 2022 (1,342 in FYE21) and in its investment plan it aims to develop around 7,000 units over the next five years, split between 31% low-cost rental, 39% shared-ownership, 10% private rent and 20% private sale.

In its rating case, Fitch expects NHG's debt to increase to about GBP4.2 billion by FYE27, following investments (FYE22: GBP3.4 billion). NHG's net debt/ EBITDA is expected to remain slightly above 12x throughout the rating case (FYE22: 14x), but peak at around 14.5x at FYE23, despite lower revenue from sales and increased spending on fire-safety improvements in existing stock. We have placed higher weighting on latter years of rating cases for providers with significant fire-safety costs, as we consider them non-recurring, and their impact not indicative of underlying credit strength. Despite this, there has been a weakening in the financial profile since the prior year, which is reflected in the Negative Outlook, demonstrating the limited headroom to negative rating triggers.

Derivation Summary

The 'a-' SCP is driven by our assessment of 'Stronger' revenue defensibility, operating risk and financial profile and a comparison with peers in the sector.

Fitch views NHG as a government-related entity (GRE) in the UK, with a support score of 12.5 based on our assessments. This results in a bottom-up approach, with a one-notch uplift to the SCP to arrive at the Long-Term 'A' IDR, reflecting modest links with the government.

Short-Term Ratings

NHG's Short-Term 'F1+'IDR is the higher of two options mapping to a 'A' Long-Term IDR, reflecting the combination of 'Stronger' revenue defensibility and a strong liquidity cushion and coverage ratio.

Liquidity and Debt Structure

NHG has significant cash and undrawn facilities available of around GBP1 billion. It also has a substantial number of unencumbered assets should the need for financing arise, and its development and acquisition programme is expected to deliver an additional 5,500 units over the next five years that could be securitised. This is more than sufficient to cover the RP's forecast borrowing requirements. NHG issued a GBP250 million sustainable bond in FY22 rated by Fitch, providing funding capacity.

NHG's debt is similar to sector peers, spread across bonds, a revolving credit facility and term loans with limited near-term maturity.

Issuer Profile

As of 1 April 2021, NHG owned or managed more than 66,500 housing units, ranking it among the largest RPs in England and a constituent member of the G15, the biggest RPs in London. NHG has strong growth aspirations and aims to provide as many affordable homes for residents as possible, with over 5,500 units planned for development or acquisition by 2026.

RATING SENSITIVITIES

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

Deterioration of net adjusted debt/ EBITDA to above 12x 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:

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

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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 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	Affirmed	A
Notting Hill Genesis	LT IDR	A Rating Outlook Negative	Affirmed	A Rating Outlook Stable
	ST IDR	F1+	Affirmed	F1+
	LC LT IDR	A Rating Outlook Negative	Affirmed	A Rating Outlook Stable
	LC ST IDR	F1+	Affirmed	F1+
senior secured	LT	A	Affirmed	A

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Notting Hill Genesis	UK Issued, EU Endorsed

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