



Fitch Affirms Notting Hill Genesis at 'A'; Outlook Stable

Fitch Ratings - Warsaw - 29 July 2019:

Fitch Ratings has affirmed Notting Hill Genesis (NHG) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A'. The Outlooks are Stable. Fitch has removed NHG's Short-Term Foreign- and Local-Currency IDRs of 'F1' from Under Credit Observation (UCO) and placed them on Rating Watch Positive (RWP).

The ratings reflect continuing high demand for social housing in London and the south-east of England, where NHG mainly operates, and continued cash flow from rented properties. They also factor in NHG's secured cash flow from public funds and the control and regulation provided through the Regulator of Social Housing (RSH), previously the Homes and Communities Agency. At 1 April 2019, NHG owned or managed more than 65,000 housing units, ranking it among the largest registered providers (RPs) in England.

The ratings also reflect NHG's moderate debt levels with stable debt metrics and satisfactory liquidity, which we expect to remain stable, despite a sizable development plan to deliver 8,500 units within the next five years. The ratings also reflect a one-notch uplift that Fitch applies to NHG's standalone credit profile (SCP), under Fitch's Government Related Entities (GRE) Criteria and assessment of strength-of-linkage and incentive-to-support factors.

The Stable Outlooks reflect Fitch's view that NHG will continue to show satisfactory performance, despite a weakened operating environment and increased challenges faced by RPs in England. The impact of Brexit on the sector, although still uncertain, appears less evident than on other public finance sectors, such as higher education and healthcare, although possible consequences have been factored into NHG's stress tests. The RSH continues to provide strong oversight.

Key Rating Drivers

The following rating factors are reflected in NHG's SCP of 'a-':

Revenue Defensibility: Strong

Fitch assesses revenue defensibility, which covers demand and pricing, as 'Strong' overall. Demand for social housing remains strong and changes to rents are unlikely to materially affect demand. The supportive regulatory regime aims to maintain compensation for essential public services. On the core operations RPs have limited revenue flexibility, as it is the UK government that determines social housing rent rises. Since April 2016, rents have been reduced by 1% a year and then on 4 October 2017, it was announced that rents would again return to consumer price index plus 1% for five years from 1 April 2020. However, due to the growing share of revenue from non-social housing activity, RPs have been collecting enough revenue to cover all costs.

Operating Risk: Strong

Operating risk, which covers operating costs and resource management, is assessed as 'Strong' overall. NHG has well-identified cost drivers and low potential volatility in major items. NHG 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. Additionally, in the event of financial stress, NHG can cut back on discretionary expenditure or non-essential major works.

Supply constraints on labour or resources are unlikely. NHG has factored in Brexit and its potential impact on the UK economy, public finances and political continuity into its stress testing. The main implications for the sector will be continued uncertainty and short- to medium-term turbulence in the financial and housing markets, which may lead RPs to further delay any planned bond issuance, and put pressure on refinancing. Nevertheless, in January 2019 NHG successfully raised GBP250 million from a 10-year bond issue at its lowest coupon to date of 2.875%.

NHG has stress-tested and run multi-variable scenarios for its business plan. In general, throughout the stress-tested business plan interest cover and gearing covenants are met, albeit with decreased headroom. In some scenarios, where multiple risks materialise all at once, interest cover could be breached if no mitigating measures are taken, which we view as unlikely. We will also closely review the robustness of NHG's stress testing relative to the ratings, including the impact of Brexit on the business plan, and assess NHG's flexibility to adapt to market conditions.

Financial Profile: Strong

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 sound performance to continue, aided by the economics of scale achieved following the recent merger of Notting Hill Housing Trust and Genesis Housing Association Limited. Profits from the sale of private sale units will be re-invested in the RP to continue to build and provide affordable social units. The share of non-social housing activity is expected to peak in financial year ending March 2021 at 35% of total turnover, from 21% in FYE19, but in the medium term on average 65% of the turnover will continue to be from social housing lettings. NHG's board and management follow a prudent approach to risk and debt. Debt will continue to increase to fund capital expenditure as outlined under NHG's development plan.

NHG developed more than 2,110 units in FY19 (FY18: 990) and in its investment plan it aims to develop more than 8,500 units over the next five years (12,500 under previous plan), split between 33% low-cost rental, 27% shared-ownership, 17% private rent and 20% private sale.

In its rating case, Fitch expects NHG's turnover to increase to an average of GBP800 million in FY20-FY24 with an operating surplus averaging a high GBP200 million a year. Debt is expected to increase to about GBP4.2 billion by FYE24 (about 4% annually) following investments. However, in relation to Fitch-calculated EBITDA net debt is expected to return to around 12x after increasing to 14.6x in FY19, the latter due to lower revenue from sales and increased spending on fire and safety improvements in existing stock, and integration costs post-merger. In FYE19, NHG reported GBP671 million turnover (FYE18: GBP696 million) and an operating surplus of GBP137 million. Debt at FYE19 was at GBP3.5 billion (FYE18: GBP3.3 billion).

Derivation Summary

Fitch rates social housing RPs in England using a bottom-up approach under its Revenue-Supported Rating Criteria and takes into account factors such as revenue defensibility, operating risks and the RP's financial profile assessment. We incorporate public support factors, notably the strong predictability of the RP's cash flow through direct and indirect government funding. Fitch also applies the GRE Criteria, under which status, ownership and control are assessed as 'Strong' for NHG. Support track record and expectations is assessed as 'Moderate' and the socio-political implications of default are assessed as 'Moderate' while the financial implications of default are assessed as 'Weak'. This gives a total score of 12.5, leading to a bottom-up + 1 under our Notching Guideline Table, and the final IDR of 'A'. As a consequence, RPs' ratings do not automatically move in line with those of the UK sovereign.

The short-term ratings have been placed on RWP following the application of Fitch's new Short-Term Criteria. For GREs that are rated on a bottom-up basis under the Revenue-Supported Debt Criteria, the higher of the short-term ratings mapping to a 'A' Long-Term IDR will apply, providing the three factors defined in the Short-Term Ratings Criteria are met (liquidity profile and debt characteristics assessed as 'neutral' and a minimum coverage ratio). Fitch will resolve the RWP within six months.

RATING SENSITIVITIES

The SCP may be revised lower if there is further pressure on the sector or on NHG as a result of a weakening operating environment in the UK.

The ratings may also be downgraded in the event of:

- Greater pressure on headroom on existing interest cover and gearing covenants.
- Further reliance on sales receipts than expected.
- Increased volatility in operating revenue as a result of higher exposure to development activities and a significant increase in gearing.
- Inability to improve on a sustained basis the net debt/Fitch-calculated EBITDA ratio to a level consistent with the current SCP (around 12x).
- Further changes passed by government negatively affecting the revenues of RPs.

Conversely, the SCP and hence the IDRs could be revised upward and upgraded, respectively, if net debt/ Fitch-calculated EBITDA declines below 10x on a sustained basis.

The UK sovereign ratings are on Rating Watch Negative (RWN) and in the event of a downgrade Fitch may re-assess the impact that the sovereign credit metrics weakening would have on the RPs' SCPs, notching uplift and rating relativity.

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
GenFinance II PLC		
senior secured	LT A Affirmed	A
GBP 250 mln 6.064% Secured Notes 21 Dec 2039 XS0474146288	LT A Affirmed	A
Notting Hill Genesis	LT IDR A ● Affirmed	A ●
	ST IDR F1 ◆ Rating Watch On	F1
	LC LT IDR A ● Affirmed	A ●
	LC ST IDR F1 ◆ Rating Watch On	F1
senior secured	LT A Affirmed	A

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Applicable Criteria

Government-Related Entities Rating Criteria (pub. 25 Oct 2018)
Public Sector, Revenue-Supported Entities Rating Criteria (pub. 28 May 2019)
Short-Term Ratings Criteria (pub. 02 May 2019)

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