



Fitch Assigns Notting Hill Genesis 'A' IDRs; Outlook Stable

Fitch Ratings-Warsaw/London-01 August 2018: Fitch Ratings has assigned Notting Hill Genesis (NHG) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) of 'A'. The Outlooks are Stable. We have assigned Short-Term Foreign- and Local-Currency IDRs of 'F1'. Simultaneously Fitch has assigned 'A' Long-term ratings to the local-currency senior secured bonds issued by NHG (parent and dominant company in the group) and its subsidiary Genfinance II Plc.

NHG's 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 3 April 2018, NHG owned or managed more than 64,000 housing units, ranking it among the largest registered providers (RPs) in England. The ratings also reflect NHG's moderate debt level with stable debt metrics and satisfactory liquidity, which is expected to remain stable, despite the sizable development plan to deliver 12,000 units within the next five years. The ratings reflect also a one-notch uplift that Fitch applies to NHG's standalone ratings, driven by the application of the Government Related Entities (GRE) Criteria and Fitch's assessment of four factors under the strength of linkage and incentive to support.

The Stable Outlooks reflect Fitch's view that NHG will continue to show satisfactory performance, despite the 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 the possible consequences have been factored into NHG's stress tests. The RSH continues to provide strong oversight.

KEY RATING DRIVERS

Fitch rates social housing RPs in England under its Revenue Supported Rating Criteria and takes into account such factors as revenue defensibility, operating risk and the RPs' financial profile assessment. We incorporate public support factors, notably the strong predictability of the RPs' cash flow through direct and indirect government funding. Fitch also applies the GRE Criteria, whereby we apply a one-notch uplift to the standalone ratings. This reflects the assessment of strength of linkage and incentive to support factors. As a consequence, RPs' ratings do not automatically move in line with those of the UK sovereign.

The following rating factors are reflected in NHG's standalone 'A-' rating:

Revenue Defensibility: Strong

Fitch assesses Revenue Defensibility, which covers demand and pricing, as strong overall. Demand for social housing remains strong and any change in the rents that RPs are able to charge would be unlikely to materially affect demand. The supportive regulatory regime aims to maintain compensation for services at a level consistently supporting solvency for not-for-profit of an essential public service. On the core business part of operations the 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 the five years from 1 April 2020. However, due to the growing share of revenue from non-social housing activity, RPs have been gaining more flexibility to collect enough revenue to cover all costs.

Operating Risk: Strong

Operating Risk covers operating costs and resource management. Fitch has assessed this overall as strong. 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 opportunities to slow down committed schemes, defer uncommitted schemes as well as switch tenure from sale to market rent. Additionally, in the event of financial stress, NHG can curtail some discretionary expenditure or spending on non-essential major works and improvements.

Regarding resource management risk, there are unlikely to be supply constraints for labour or resources. NHG has factored the Brexit vote 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 issuances, and put pressure on refinancing. Nevertheless, in October 2017 NHG successfully raised GBP400 million in a 31-year bond issue at the group's lowest coupon to date of 3.25%.

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 at once, interest cover could be breached, but only when no corrective measures are performed, which is unlikely. Fitch will continue to monitor the resilience of NHG and assess its ability to overcome possible further turmoil. We will also closely review the robustness of the stress testing relative to its ratings, including the impact of the Brexit vote on its business plan, and assess NHG's flexibility to adapt to market conditions.

Financial Profile: Strong

Fitch believes NHG is showing sound 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 debts 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 FYE21 at 36% from 23% in FYE18 of total turnover, but in the medium term on average 70% of the turnover will continue to be from social housing lettings and sales. NHG's board and management follow a prudent approach to risk and debt. Debt will continue to increase to fund capital expenditure on development programmes.

NHG as developed more than 990 units in FYE18 (FYE17: 1,346; combined data for two legacy entities) and it aims to develop more than 12,000 units over next five years, with the tenure split expected to be 27% low cost rental, 36% shared ownership, 18% private rent and 19% private sale.

In its rating case scenario, Fitch expects NHG's turnover to increase to about GBP1 billion in FY19-23 with the operating surplus averaging a high of GBP350 million a year. Debt is expected to increase to about GBP4.6 billion by FYE23 (about 7% annually) following investments. However, net debt to Fitch-calculated EBIDTA is likely to remain around 11x-12x, and in line with the lower end of 'A' category peers. In FYE18, NHG reported GBP696 million turnover (FYE17: GBP676 million) and an operating surplus of GBP170 million. Debt at FYE18 was at GBP3.3 billion (FYE17: GBP2.9 billion).

Under Fitch's GRE criteria status, ownership and control are assessed as Strong. We assess support track record and expectations as Moderate, the socio-political implications of default are assessed as Moderate and the financial implications of default as Weak. This gives a total score of 12.5, leading to a bottom up + 1 under the Notching Guideline Table.

RATING SENSITIVITIES

The standalone ratings may be downgraded if there is further pressure on the sector or on NHG as a result of the negative 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 currently expected.
- Increased volatility in operating revenue as a result of higher exposure to development activities and a significant increase in gearing and net debt/Fitch calculated EBITDA ratios.
- Further changes passed by government negatively affecting the revenues of RPs.

Conversely, the standalone rating and hence the IDRs could be upgraded if net debt to Fitch calculated EBIDTA declines below 10x on a sustained basis.

The Outlook on the UK sovereign is Negative and in the event of further downgrade Fitch may re-assess the impact that the sovereign credit metrics weakening would have on the RPs' standalone credit profiles, notching uplift and ratings relativity.

FULL LIST OF RATING ACTIONS

Long-Term Foreign- and Local-Currency IDRs assigned at 'A'; Outlooks Stable

Short-Term Foreign- and Local-Currency IDRs assigned at 'F1'

Long-term ratings of the local-currency senior secured bonds issued by Notting Hill Genesis and Genfinance II Plc assigned at 'A'

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Applicable Criteria

Government-Related Entities Rating Criteria (pub. 07 Feb 2018)

(<https://www.fitchratings.com/site/re/10019302>)

Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)

(<https://www.fitchratings.com/site/re/10020113>)

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