Research Update:

U.K.-Based Social Housing Provider Notting Hill Genesis Affirmed At 'A-'; Outlook Stable

February 17, 2022

PRIMARY CREDIT ANALYST

Abril A Canizares
London
+ 44 20 7176 0161
abril.canizares@spglobal.com

SECONDARY CONTACT

Karin Erlander
London
+ 44 20 7176 3584
karin.erlander@spglobal.com

RESEARCH CONTRIBUTOR

Hugo Caparros
London
hugo.caparros@spglobal.com

Overview

- While we estimate that Notting Hill Genesis' (NHG's) financial indicators will reduce because of increased investments in existing stock, we expect they will remain commensurate with the current rating.
- We forecast that S&P Global Ratings-adjusted EBITDA margins will exceed 20%, nonsales EBITDA interest cover will be slightly above 1x, and debt will remain elevated above 20x nonsales adjusted EBITDA.
- We believe that NHG will maintain a very strong liquidity position, partly thanks to reliable access to funding, as evidenced by a string of borrowings throughout the pandemic.
- We affirmed our long-term issuer credit rating on NHG at 'A-'. The outlook is stable

Rating Action

On Feb. 17, 2022, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on U.K. social housing provider Notting Hill Genesis. The outlook is stable.

We also affirmed our 'A-' long-term issuer credit rating on NHG's subsidiary, Notting Hill Home Ownership (NHHO). The outlook is stable.

We affirmed our 'A-' issue ratings on all five bonds and the £2 billion senior unsecured medium-term note program issued by NHG. We also affirmed the 'A-' issue rating on the £250 million bond, due 2039, issued by the treasury vehicle GenFinance II PLC, considered a core subsidiary of the group.

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 a weaker interest cover.

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

The rating affirmation reflects our expectation that although NHG's adjusted EBITDA margins have fallen compared with previous years, they will remain above 20%. This would preserve a robust interest coverage and a very strong liquidity position. We expect NHG's management to be consistent with its strategy and to continue dealing prudently with its level of sales exposures. Therefore, we anticipate that revenue from sales activities, including those from joint ventures, will not exceed a third of the group's total revenue on a sustained basis.

NHG benefits from its core operations in the predictable and countercyclical social-housing sector. It is predominantly focused on London, the U.K.'s economic, financial, and administrative hub. We estimate that NHG's average rent to market rent will likely remain at about 54%, which supports robust demand prospects for the group's stock. We expect vacancy rates to remain low and broadly in line with the sector, at about 1.5%. Furthermore, in our view, NHG is better positioned than smaller peers to resist external shocks, thanks to its substantial number of units under management.

We assess the regulatory framework under which registered providers of social housing in England operate as strong, underpinned by their public policy mandate to provide affordable homes. We also consider that the sector benefits from solid ongoing oversight by the Regulator for Social Housing (RSH). These strengths are offset, in our view, by the relatively low levels of grant funding that the providers in England receive for the development of affordable homes. Social housing providers in England can develop homes for outright sale, using the proceeds as an alternative funding source, but we think that this exposes them to risks and potential volatility compared with providers in other regions. Providers in England are also subject to negative intervention from the U.K. government in the form of constraints on rent setting or additional spending responsibilities, without adequate additional funding. In our view, this weighs on the regulatory framework assessment.

We consider NHG's management has sufficient expertise to address short- to medium-term difficulties by adapting its business plan to market conditions. The group strategy targets annual development of 1,400 units. This was scaled down in 2020 from previous plans, which at the time of the merger in 2018 aimed to develop 2,700 units per year.

The revision of NHG's strategy in 2020 reflected the need to increase investments on existing stock, and stemmed from the high levels of unsold stock back in 2019. NHG had 548 units of unsold stock on the balance sheet at the end of fiscal year ending March 31, 2021, out of 794 of homes completed for sale during the year. As of Dec. 31, 2021, the group reduced its unsold units to 251 units, from the 937 that were available for sale in April 2021.

We forecast that NHG's financial performance will weaken, mainly because of a steep increase in investments in the group's existing stock. Over fiscal years 2022-2024, NHG's adjusted EBITDA margins will reduce but remain above a moderate 20% of revenue. NHG's strategy targets a high level of capitalized repairs, which will reach close to £120 million, spread over fiscal years 2022-2024; a steep increase from the past three years, when these added about £40 million. The repairs program largely addresses fire safety works, while including investments to bring all its homes up to the Energy Performance Certificate (EPC) C level by 2030; at present, more than 70% of the group's stock is already at EPC C or above.

We expect that through fiscal 2024, the development program will be partly financed with proceeds from asset sales. This will prevent large debt increases and support adjusted nonsales EBITDA interest cover between 1x and 1.1x, despite debt remaining elevated over 20x our forecast nonsales adjusted EBITDA. We factor in the reduction in the group's cost of debt after the lower interest rates achieved in 2021's issuances.

We believe that there is a moderately high likelihood that NHG would receive extraordinary support from the government via the RSH in case of financial distress. This provides a one-notch uplift from its stand-alone credit profile (SACP). As one of the key goals of the RSH is to maintain lender confidence and low funding costs across the sector, we believe the RSH is likely to step in to try to prevent a default in the sector. The RSH has a record of mediating mergers or arranging liquidity support from other registered providers in cases of financial distress and we think this would apply to NHG.

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 1.5x. 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 £314 million;
- Cash balances of about £49 million;
- Undrawn committed bank lines of about £793 million;
- Fixed asset sales of close to £75 million; and
- Other cash inflows totaling around £15 million.

Uses of liquidity include:

- Capital expenditure and development spend of close to £410 million; and
- Interest and principal repayments of about £390 million.

Key Statistics

Table 1

Notting Hill Genesis--Key Statistics

	--Year ended March 31--				
Mil. £	**2020a**	**2021a**	**2022e**	**2023bc**	**2024bc**
Number of units owned or managed	64,847	66,537	67,298	67,709	68,161
Adjusted operating revenue	721.2	896.2	869.7	715.5	758.4
Adjusted EBITDA	203.5	248.0	196.7	170.8	192.9
Non-sales adjusted EBITDA	171.9	174.4	162.0	154.8	171.6
Capital expense	297.1	244.7	501.4	399.0	451.4
Debt	3,486.2	3,379.3	3,433.3	3,611.4	3,818.0
Interest expense	146.9	143.1	148.8	149.3	154.8
Adjusted EBITDA/Adjusted operating revenue (%)	28.2	27.7	22.6	23.9	25.4
Debt/Non-sales adjusted EBITDA (x)	20.3	19.4	21.2	23.3	22.3
Non-sales adjusted EBITDA/interest coverage(x)	1.17	1.22	1.09	1.04	1.11

a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Ratings Score Snapshot

Table 2

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

- Social Housing Outlook 2022: Green Agenda Takes Root In Investment Plans, Nov. 23, 2021
- How U.K. Public Finance Sectors Fare Under Latest Spending Review, Nov. 11, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 22, 2021
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers, June 8, 2021
- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021

Ratings List

Ratings Affirmed	
Notting Hill Genesis	
Notting Hill Home Ownership Ltd.	
Issuer Credit Rating	A-/Stable/--
Notting Hill Genesis	
Senior Secured	A-
GenFinance II PLC	
Senior Secured	A-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.