S&P Global
Ratings

RatingsDirect®

Research Update:

Notting Hill Housing Trust Affirmed at 'A+'; Outlook Remains Negative

Primary Credit Analyst:
Jean-Baptiste Legrand, London (44) 20-7176-3609; jb.legrand@spglobal.com

Secondary Contact, Sovereigns And International Public Finance:
Dennis Nilsson, Stockholm (46)84405354; dennis.nilsson@spglobal.com

Research Contributor:
Foram Patel, Mumbai 91-22-40402975; foram.patel@spglobal.com

Table Of Contents

Research Update:

Notting Hill Housing Trust Affirmed at 'A+'; Outlook Remains Negative

Overview

- We continue to expect that U.K.-based social housing provider Notting Hill Housing Trust (Notting Hill) will increase its market-related activities in the next two to three years, which may put margins under pressure and expose the group to more volatility.
- Nevertheless, we believe Notting Hill's very strong liquidity and experienced management will allow it to adequately adapt to the developing sector.
- We are therefore affirming our long-term issuer credit rating on Notting Hill at 'A+'.
- The negative outlook reflects our view that if the financial performance and debt deteriorate beyond our current base-case expectations over the next 12 months, we would lower our ratings on Notting Hill. In the meantime, we currently anticipate that the forthcoming merger with Genesis Housing Association will have a neutral impact on the ratings.

Rating Action

On Sept. 15, 2017, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K. social housing provider Notting Hill Housing Trust (Notting Hill). The outlook remains negative. We also assigned our 'A+' issue rating to Notting Hill's proposed benchmark senior secured bond issuance.

At the same time, we affirmed our long-term issuer credit rating on Notting Hill's subsidiary, Notting Hill Home Ownership (NHHO), at 'A+'.

Rationale

The ratings affirmation reflects our view that Notting Hill's very strong liquidity and management's proactive stance on the risks associated with sector and external environment changes will help mitigate risks stemming from an increasing exposure to market tenures. We also acknowledge the successful actions taken to decrease arrears over the past few years in order to improve the group's operational performance. We base our ratings on Notting Hill on our assessment of its stand-alone credit profile (SACP), which remains 'a+'.

Notting Hill's SACP, which we assess on a consolidated group level, is supported by its very strong enterprise profile in the social housing industry, which continues to carry low risk in our view. Notting Hill is one of London's major housing associations, with about 32,000 units under management as of fiscal year end 2017, and benefits from the high demand for social housing in its operations areas. We also factor in Notting Hill's strong management with a good track record of substantially improving its financial performance over the past years. Operational performance is excellent in terms of voids (1.0% recorded over 2015-2017) and we now acknowledge management's successful work in reducing the late payments, and expect the current arrears level to remain stable in the coming years.

Notting Hill's sound financial strategy has led the group to substantially improve its profitability over the past five years. While we foresee a gradual decrease in adjusted EBITDA margins in our 2016-2020 base case (to 35% in 2020 from 42% in 2016), we observe Notting Hill's profitability remains higher than its U.K. peers (in particular its G15 rated peers). However, we continue to see increased pressure on Notting Hill's financial profile. English housing associations will be subject to the 1% annual rent cut until 2020, while inflation is rising in the U.K. and driving up costs, which stresses margins. Market-related activities, predominantly shared ownership first-tranche sales and outright sales, are lower-margin activities that are likely to be affected by rising costs (in particular build costs) and a real estate market slowdown in London, in our view.

Notting Hill has an ambitious capital program concentrated in London and plans to develop approximately 6,800 homes over the next five years. The development plan will be split among shared ownership (about one-third), affordable rent (about one-third), and private sales and market rent (about one-third). We continue to factor into Notting Hill's financial profile its substantial exposure to market-driven activities, as shared ownership first tranche sales and private sales will account for about 50% of its turnover in our 2020 updated base-case forecast.

Given Notting Hill's large development program, we anticipate a debt increase in the next few years (to about £2 billion in financial year [FY] 2020, ending March 31, from £1.3 billion in FY2017), close to our former base-case projection. Our debt forecast over the coming years will weigh on the debt to adjusted EBITDA that we believe will increase to more than 10x over 2018-2020, with interest coverage to remain at above 2.5x in the same period. In our updated base case, we believe that unencumbered assets value (EUV-SH value) will fall below 50% of outstanding debt once the planned bond issuance will be completed in the next weeks. That said, we assess Notting Hill's loan-to-value at below 50%, which we view positively.

We continue to acknowledge that the moderately high likelihood of Notting Hill receiving extraordinary support from the U.K. government, working through the Homes and Communities Agency, has a neutral effect on the ratings.

In accordance with our criteria for government-related entities, we base our view of the likelihood of extraordinary government support on our assessment of Notting Hill's important role for the U.K. government and its public-policy mandate, and its strong link with the government. The U.K. government has a track-record of providing extraordinary support to the sector in case of distress.

Liquidity

We continue to assess Notting Hill as having a very strong liquidity position. We foresee Notting Hill's existing sources of liquidity exceeding its expected uses over the next 12 months by 1.4x (from 1.8x previously). This change mainly stems from a higher investment effort expected over the next 12 months. Notting Hill group benefits from about £400 million of committed undrawn bank facilities as well as solid cash flows. We also expect Notting Hill to secure a new bond issuance shortly that will allow it to cover its funding needs over the forecast period.

Given Notting Hill's track record of accessing the capital markets many times since 2011 and securing low margins relative to the sector, we continue to view the group's access to external liquidity as strong.

Outlook

The negative outlook reflects our view that if the financial performance and debt position deteriorate beyond our current base-case expectations over the next 12 months due to the group's elevated risk profile from market-related activities, we would lower our ratings on Notting Hill. We also consider that pressure on the ratings could come from risks relating to the proposed merger with Genesis Housing Association. However, we currently anticipate that the forthcoming merger with Genesis Housing Association will have a neutral impact on the ratings.

We would revise the outlook to stable over the next year if we believed that Notting Hill's strategy and risk stemming from exposure to market tenures would not have a material impact on its credit ratios.

Notting Hill Housing Trust Selected Financial Indicators

Year Ended	**March 31**				
Balance Sheet Date Year	2016a	2017a	2018bc	2019bc	2020bc
('000 £)					
Number of units	30,660	31,855	33,603	34,927	36,114
Vacancy rates (% of rental income)	1.0	0.9	1.00	1.00	1.00
Arrears (% of rental income)*	5.0	5.0	5.50	5.20	5.00
Revenues§	400,200	398,500	398,132	410,853	586,501
Share of revenue from non-traditional activities (%)	48.2	45.9	46.1	46.0	60.3
Operating expense (before D&A)	225,400	226,600	238,773	241,169	373,274
EBITDA¶	168,000	163,600	150,444	159,757	203,110
EBITDA/revenue (%)	42.0	41.1	37.8	38.9	34.6
Interest expense	58,000	55,500	65,937	70,520	75,014
Debt/EBITDA (x)	7.7	8.2	11.4	12.4	9.7
EBITDA/interest coverage (x)†	2.7	3.0	2.3	2.3	2.7
Capital expense	173,600	265,900	312,550	379,050	321,100
Debt	1,297,600	1,336,300	1,714,041	1,976,850	1,960,093
Housing properties (according to balance sheet valuation)	3,063,900	3,182,000	3,455,120	3,795,824	4,075,773
Loan to value of properties (%)	42.4	42.0	49.6	52.1	48.1
Cash and liquid assets	80,900	56,400	258,032	280,187	121,009

*Rent and service charge arrears. §Adjusted for grant amortization. ¶Adjusted for capitalized repairs. †Including capitalized interest. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available. Note: Our updated base-case forecast continues to solely reflect our financial projections for Notting Hill on a stand-alone basis and does not, at this stage, incorporate Notting Hill's likely merger with Genesis Housing Association.

Related Criteria And Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Criteria - Governments - General: Methodology For Rating Public And Nonprofit Social Housing Providers - December 17, 2014
- General Criteria: Group Rating Methodology - November 19, 2013
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Research Update: Genesis Housing Association 'A-' Rating On CreditWatch Positive On Potential Merger With Notting Hill Housing Trust, July 21, 2017
- Research Update: Notting Hill Housing Downgraded To 'A+' On Weakening Financial Profile; Outlook Negative On Heightened Sales Risk
- U.K. Social Housing Risk Indicators, June 9, 2017
- Ratings On the United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 28, 2017
- High Demand For U.K. Social Housing Will Push Sector's Debt Above £80 Billion In FY2019, March 20, 2017
- Credit FAQ: Brexit Uncertainties Mean Higher Credit Risks And Lower Ratings For The U.K. Social Housing Sector, Oct. 31, 2016

Ratings List

	Rating	
	To	From
Notting Hill Housing Trust		
Issuer Credit Rating		
Foreign and Local Currency	A+/Negative/--	A+/Negative/--
Notting Hill Home Ownership Ltd.		
Issuer Credit Rating		
Foreign and Local Currency	A+/Negative/--	A+/Negative/--

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. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site 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.