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Research Update:

U.K.-Based Genesis Housing Assn. Assigned 'A-' Rating; Outlook Negative

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Table Of Contents

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Overview

- Genesis Housing Association (GHA) is a U.K.-registered provider of social housing operating in London and the South East.
- We assess GHA's enterprise profile as strong and its financial profile as adequate, resulting in a stand-alone credit profile of 'bbb'.
- We also believe that GHA benefits from a moderately high likelihood of receiving extraordinary support from the U.K. government, working through the Homes and Communities Agency (HCA), which results in a two-notch uplift from the SACP.
- We are therefore assigning our 'A-' long-term issuer credit rating to GHA.
- The negative outlook reflects that on the long-term rating on the U.K. because we would lower the ratings on GHA if we lowered the sovereign rating by one notch, all else being equal. We could also lower the rating on GHA if its EBITDA and cash flow generation came under pressure, or debt increased beyond our base case, resulting in weaker margins, higher leverage, and pressure on liquidity

Rating Action

On March 9, 2017, S&P Global Ratings assigned its 'A-' long-term issuer credit rating to U.K. social housing provider Genesis Holding Association (GHA). The outlook is negative.

Rationale

The 'A-' rating on GHA is based on its 'bbb' stand-alone credit profile (SACP). It is also based on our opinion that there is a moderately high likelihood that the U.K. government, working through the Homes and Communities Agency (HCA), would provide timely and sufficient extraordinary support to GHA in the event of financial distress.

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

GHA's SACP is supported by its strong enterprise profile. We continue to assess the industry in which GHA operates as low risk, given solid demand for social housing assets and ongoing support from the government through the regulatory framework.

GHA operates in a particularly strong segment of the market. GHA's activities are mainly focused in the London and South East areas, both regions that are more dynamic in terms of average annual population growth rates than the rest of the U.K. and also benefit from very low social rents compared with market rent, further

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supporting demand. That said, we think that similar to its London-based peers, the group's exposure to non-traditional activities, and in particular open market sales, exposes it to higher risks than typically seen in the social housing sector. GHA generated close to 40% of its revenue from non-traditional activities in fiscal year 2016, of which close to 20% pertained to development for sale. Notwithstanding an expected decline in 2017 due mainly to delays in the development plan, we understand that GHA aims to build 9,500 new homes over the next 10 years, mainly for shared ownership and outright sale.

Asset quality is high but, while on an improving trend, we note that the group's current tenant arrears have averaged 6% of rent receivables over past three years. While arrears had improved to less than 5% in the year to March 2016, we think that they could increase generally in the sector amid welfare reforms that include benefit caps and the introduction of universal credit. We also consider that GHA, with an average age of the asset portfolio of 35 years, compares well with other London-based peers, but that vacancy rates are higher than the peer group. It had voids of 2.7% in the fiscal year to March 31, 2016, compared with London-based peers reporting vacancy rates of between 0.7% and 1.3% for the same period. We note, however, that GHA's vacancy rates were higher because of site specific issues within the market rent and temporary housing portfolio, which have been addressed in the current year.

We consider GHA's strategy and management to be satisfactory, underpinned by a solid management team and a long-term planning process. We understand that GHA has implemented a range of cost-saving measures to counter the 1% annual rent cuts imposed by the regulator for four years from April 1, 2016. This is positive, in our view, in particular given the potential pressure on profitability that might stem from inflation-driven increases in input and labor costs. We think there might be risks relating to the structure around the LINQ Housing entity, in which GHA will hold a 25% stake, and to which the group aims to sell its development for sale assets if not sold directly on the open market. LINQ Housing would finance the acquisition with debt, which we understand would be non-recourse to GHA.

We assess GHA's financial profile as adequate on account of lower profitability, higher leverage, and lower interest coverage ratios than peers. We think that the group's tolerance for debt is high, which, combined with a large proportion of market sales activities, could expose the group to greater risk in view of potentially more volatile earnings and cash flows to support debt service coverage ratios. GHA's adjusted EBITDA margin (where we adjust GHA's reported EBITDA for capitalized repairs) declined to 22% in the year to March 2016, from 25% in the previous year. While we expect profitability to strengthen, we do not think GHA's EBITDA margins will come close to 30%, and consider that GHA's adjusted EBITDA margins of about 24% through the forecast period is significantly lower than peers in the London area that typically have EBITDA margins of 30%-40%.

GHA has the highest leverage in the peer group, with adjusted debt to EBITDA exceeding 17x in fiscal 2016, and edging up to 19x under our base case because we assume that a large proportion of its development program will be debt financed. Under our base case, the group's interest cover ratios are also relatively low through the forecast period, at around 1.0x-1.1x compared with 1.2x in fiscal 2016. We think GHA will spend £125 million and more than £350 million on developments in fiscal 2017 and 2018, respectively, and will likely fund this with a combination of internally generated cash flow and proceeds from assets sales, but above all debt.

Liquidity

We assess GHA's liquidity as strong, with sources exceeding uses by 1.4x under our base case. We consider that GHA's access to the capital markets is satisfactory. Sources of liquidity as of Sept. 30, 2016 include forecasted cash generated from continuing operations of more than £55 million; cash and liquid investments of close to £63 million; our view of confidently predictable proceeds from asset sales of about £62 million; and access to the undrawn, available portion of committed bank facilities or bank lines, maturing beyond the next 12 months, of close to £260 million. Uses of liquidity include expected capital expenditure of more than £190 million, as well as interest and principal payable on short- and long-term debt obligations coming due of about £122 million.

Outlook

The negative outlook reflects that on the sovereign, because we would lower the ratings on GHA if we lowered the sovereign rating by one notch, all else being equal. We could also lower the rating on GHA within the next two years if its EBITDA and cash flow generation came under pressure, or debt increased beyond our base case, resulting in weaker margins, higher leverage, and pressure on liquidity. We also consider that contingent liabilities could increase and will monitor the development of the relationship with LINQ Housing.

Upside Scenario

A revision of the outlook to stable would depend on the outlook on the sovereign being revised to stable. Less pressure on the rating could also come from a substantial strengthening of GHA's profitability, with EBITDA margins exceeding 30% with a simultaneous improvement in its debt service ratios. In this scenario, we would expect leverage and interest cover ratios to be more in line with the London peer group, indicated by debt to EBITDA of less than 15x and interest coverage of more than 1.5x.

Genesis Housing Assn. Financial Statistics

	--Year Ended 31-Mar--				
(Mil. £)	**2015**	**2016**	**2017bc**	**2018bc**	**2019bc**
Number of units	32,639	32,319	31,100	31,100	31,500
Vacancy rates (% of net rental income)	2.3	2.7	N.A.	N.A.	N.A.
Arrears (% of net rental income)*	6.1	4.8	N.A.	N.A.	N.A.
Revenue§	354.0	401.3	343.5	363.5	413.5
Share of revenue from nontraditional activities (%)	32.1	37.9	26.9	30.0	37.4

Genesis Housing Assn. Financial Statistics (cont.)

	--Year Ended 31-Mar--				
(Mil. £)	**2015**	**2016**	**2017bc**	**2018bc**	**2019bc**
Operating expense	277.6	317.9	262.5	277.5	315.0
EBITDA†	89.7	86.6	82.5	86.7	100.2
EBITDA/revenues	25.3	21.6	24.0	23.9	24.2
Interest expense	68.8	70.7	73.8	80.3	98.0
Debt/EBITDA (x)	17.0	17.3	17.8	20.0	19.2
EBITDA/interest expense (x)‡	1.3	1.2	1.1	1.1	1.0
Capital expense	23.3	28.3	125.2	361.4	374.2
Debt	1,527	1,496	1,485	1,725	2,195
Housing properties (EUV-SH)	N.A.	3,020	N.A.	N.A.	N.A.
Loan to value of properties (%)	N.A.	49.5	N.A.	N.A.	N.A.
Cash and liquid assets	86.6	116.3	86.8	N.A.	N.A.

*Current arrears. §Adjusted for grant amortization. †Adjusted for capitalized repairs. ‡Including capitalized interest. a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

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: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- U.K. Social Housing Risk Indicators - November 9, 2016
- Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative On Brexit Uncertainties - October 28, 2016

Ratings List

Genesis Housing Association	
Issuer Credit Rating	
Foreign and Local Currency	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.