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Research Update:

Rating On U.K.-Based Jerrold Holdings Raised To 'BB-' On Criteria Update; Outlook Stable

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Table Of Contents

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Overview

- Following a review of specialist U.K. secured lender Jerrold Holdings Ltd. under Standard & Poor's revised criteria for nonbank financial institutions, published on Dec. 9, we have raised our issuer credit rating on Jerrold to 'BB-' from 'B+'.
- We have also raised the rating on Jerrold's senior secured bond (issued by Jerrold FinCo PLC) to 'BB-' from 'B+'.
- Jerrold has a relatively narrow business focus on second-lien residential lending, bridging finance, and specialist lending, leading to higher nonperforming loans, but the company benefits from fairly predictable high-margin earnings and very strong capitalization.
- The stable outlook reflects our expectation that the management team will continue to make solid progress to work out legacy loan vintages, expand the business, and deepen operational capability, and that our risk-adjusted capital ratio will remain comfortably above 15%.

Rating Action

As we previously announced on Dec. 12, 2014, Standard & Poor's Ratings Services raised its long-term issuer credit rating on specialist U.K. secured lender Jerrold Holdings Ltd. to 'BB-' from 'B+'. The outlook is stable.

At the same time we raised the rating on Jerrold's senior secured bond, issued by Jerrold FinCo PLC, to 'BB-' from 'B+'.

Rationale

We base our rating on Jerrold on the company's relatively narrow business diversity; its focus on second-lien residential lending, bridging finance, and specialist lending; and its reliance on regularly refreshing its sources of funding given its brisk loan growth plans. Positive factors include its useful niche competitive position, fairly predictable and high-margin earnings, and our very strong capital assessment.

Jerrold is a nonoperating holding company (NOHC). Our ratings on Jerrold reflect the 'bb-' group credit profile (GCP), that is, our view of the creditworthiness of the consolidated group. We do not consider that there are any material barriers to cash flows from the main operating subsidiaries to the NOHC. We therefore do not notch down the ratings on Jerrold from our view of the GCP.

Our anchor for finance companies operating in the U.K. is 'bb+'. We believe that the main risk for these companies is industry risk. Finance companies do not have central bank access, which limits their financial flexibility, particularly during times of financial stress. They face strong competition from banks and from each other and, given their concentration in fewer business lines, their revenues can be volatile. Finance companies in the U.K. are regulated by the Financial Conduct Authority (FCA) as opposed to the Prudential Regulatory Authority (PRA) under the Bank of England. In general they have weaker regulatory requirements than banks and face less-comprehensive oversight. Our view of economic risk in the U.K. reflects the high level of private sector debt built up during the last credit and housing market boom. Given the high housing prices relative to historical levels and current incomes; the extent of leverage; and the likely impact of rises in interest rates, we consider that economic imbalances persist.

We assess Jerrold's business position as "moderate" based on its focus on U.K. residential property lending, including second-charge mortgages and bridging finance. This concentration is mitigated by fairly predictable, high-margin earnings and a reasonable geographic spread between corporate and retail lending across the U.K. Jerrold has operated for about 40 years and its management team is stable.

Capital and earnings are "very strong," in our view. On June 30, 2014, Jerrold's risk-adjusted capital (RAC) ratio was 25.5%, which compares favorably with other rated finance companies, as well as rated U.K. banks. Almost all of the shareholders' equity comprises common equity, which has been built up over many years through retained earnings and the absence of dividends. We project that Jerrold's RAC ratio will reduce considerably over the next two years, as a result of the company's brisk loan growth plans, but we expect the RAC ratio to remain comfortably above 15%, the threshold for a "very strong" capital and earnings assessment. Although it is not part of our base-case scenario, we see a meaningful risk that a change in ownership could lead to an alteration in the level and composition of capital.

We consider Jerrold's risk position to be "moderate," reflecting its focus on second-lien residential lending, bridging finance, and specialist mortgage lending, which we consider to be inherently higher-risk lending activities. Given the nature of lending, we consider that the quality of underwriting needs to be consistently strong. These concerns are moderated given Jerrold's relatively conservative approach to loan-to-value underwriting. We consider this policy critical as high collateralization is the key mitigating factor for the relatively high arrears in Jerrold's loan book.

Our assessment of Jerrold's funding is "moderate," reflecting our expectations that it will undertake further funding initiatives given the likely brisk pace of loan growth. This strategy renders Jerrold sensitive to changes in debt market conditions, in our view.

We consider Jerrold's liquidity to be "adequate." Given the relatively simple nature of its balance sheet and fairly predictable cash flows, we do not consider liquidity to be a major risk. Jerrold aims to keep a satisfactory cash buffer available at all times (over and above cash that is encumbered with its conduit facility).

We apply a negative comparable ratings adjustment to capture the risks outside the standard assumptions arising from the entity-specific factors. Given Jerrold's profile, we also compare it to established U.K. banks and challenger U.K. banks. With a loan book of only £1.1 billion at June 30, 2014, Jerrold has a relatively narrow profile in comparison to rated peers, in our view. And although nonperforming loans have been falling, they still remain relatively high, which is indicative of the nature of Jerrold's chosen business.

We rate Jerrold's senior secured bond at the same level as the issuer credit rating. This is because there is no priority debt--other than the non-recourse securitization conduit, which we exclude from our asset test--and because we expect unencumbered assets to continue to exceed the size of the secured bond.

Outlook

The stable outlook reflects our expectation that Jerrold will maintain its solid earnings performance, consistent strategic focus, and acceptable asset quality.

We could lower the ratings on Jerrold if the ownership structure changes, which is possible over the next one to two years given the involvement of private equity interests, and this leads to capital weakening more than we currently expect. Additionally, we could consider a downgrade if very high loan growth over the next 12-24 months leads us to consider that future business prospects will be less predictable.

We could raise the ratings if we observe a further reduction in nonperforming loans, sustainable growth without an associated deterioration in asset quality, improved bottom-line earnings, and maintenance of very strong capital. However, we consider the likelihood of an upgrade to be limited at present.

Ratings Score Snapshot

Issuer Credit Rating	BB-/Stable/--
SACP	bb-
Anchor	bb+
Business Position	Moderate (-1)
Capital and Earnings	Very Strong (+2)
Risk Position	Moderate (-1)
Funding and Liquidity	Moderate/Adequate (-1)

Comparable Ratings Adjustment	Negative (-1)
Support	0
GRE Support	0
Group Support	0
Government Support	0
Additional Factors	0

Related Criteria And Research

Related criteria

- Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014

Related research

- Standard & Poor's Applies Its Revised Nonbank Financial Institutions Criteria To Five European Nonbank Finance Companies, Dec. 12, 2014

Ratings List

Upgraded	To	From
Jerrold Holdings Ltd.		
Counterparty Credit Rating	BB-/Stable/--	B+/Positive/--
Jerrold FinCo PLC		
Senior Secured*	BB-	B+

*Guaranteed by Jerrold Holdings Ltd.

Additional Contact:
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