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CREDIT OPINION
3 June 2019

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RATINGS

Orbit Group Limited

Domicile	United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Orbit Group Limited

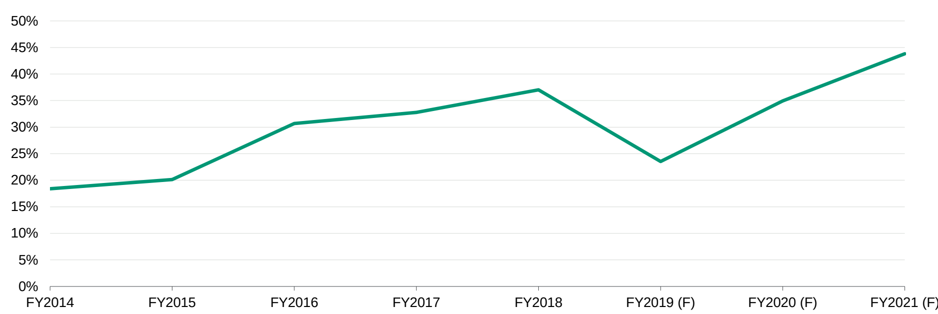
Update following rating downgrade and change in outlook to stable from negative

Summary

The credit profile of Orbit Group Limited (A3, Stable) ("Orbit") reflects its established market position, sufficient liquidity and sizeable unencumbered asset position, traditionally stable debt metrics, and the group's straightforward governance structure. Counterbalancing the strengths of Orbit are the scaling up of its development programme, an increasing proportion of forecast revenue stemming from market sales, and large exposure to standalone swaps. Orbit benefits from the strong regulatory framework governing English housing associations and our assessment that there is a strong likelihood that the UK government (Aa2 stable) would intervene in the event that Orbit faced acute liquidity stress.

Exhibit 1

The contribution of markets sales to turnover continue to increases, exceeding 40% in FY2021
Market sales as a % of turnover, FY2014-FY2021 (F)



Source: Orbit and Moody's Investors Service

Credit strengths

» Ample liquidity and sizeable pool of unencumbered assets

» Debt metrics forecast to remain relatively stable, despite planned borrowing increase

» Strong market position, simple structure, adept governance and risk management

Credit challenges

» Ambitious development plan increasing capital expenditure and market sale exposure

» Weaker operating margin than peers driven by lower margin sales activity

» Exposure to capital market volatility as a result of large standalone swap portfolio

Rating outlook

The change of Orbit's outlook to stable from negative reflects an expectation that Orbit is well positioned in the A3 rating category in the medium term, based on our assessment of the current business plan.

Factors that could lead to an upgrade

Upwards pressure on the rating could result from one or a combination of the following: 1) a material reduction in Orbit's planned development programme, further enhancing liquidity cover ratios and forecast debt metrics, (2) a reduced risk profile as evidenced in a reduction in exposure to market sales, (3) CVIC maintained at over 2x, and (4) enhanced overall profitability, with operating margins maintained near 30%.

Factors that could lead to a downgrade

Negative pressure on the rating could result from one or a combination of the following: (1) increasing reliance on market sales revenues above currently planned levels, (2) further scaling up in the development plan, leading to a reduction in liquidity cover, and (3) a rise in borrowing above currently planned levels and a material weakening of debt metrics. In addition, a weaker regulatory framework, a dilution of the overall level of support from the UK government, or a downgrade of the UK sovereign rating could exert downward pressure on the rating.

Key indicators

Orbit Group	31-Mar-14	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19*	31-Mar-20*
Units under management (no.)	37,336	38,494	39,231	40,610	42,417	43,027	43,226
Operating margin, before interest (%)	27.8	27.7	24.4	25.4	25.4	28.3	26.1
Net capital expenditure as % turnover	45.6	59.6	40.9	57.6	24.9	62.1	31.2
Social housing letting interest coverage (x times)	2.0	1.9	1.5	1.6	1.6	1.0	1.5
Cash flow volatility interest coverage (x times)	2.1	2.2	1.9	1.7	2.1	1.4	1.5
Debt to revenues (x times)	3.4	3.6	3.4	3.4	3.4	4.7	4.0
Debt to assets at cost (%)	39.1	46.2	48.5	50.0	48.8	51.2	49.6

Note: FY2019 are estimates, FY2020 are forecasts, interest coverage metrics in FY2019 incorporate breakage cost estimates from refinancing exercise. If breakage cost estimates are excluded, our social housing letting interest coverage and cash flow volatility interest coverage metrics in FY2019 would range between 1.4x - 1.5x, and 1.9x - 2.0x respectively.
Source: Orbit and Moody's Investors Service

Detailed credit considerations

The credit profile of Orbit, as expressed in the A3 rating combines (1) a baseline credit assessment (BCA) for the entity of baa1 and (2) a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline credit assessment

Ample liquidity and sizeable pool of unencumbered assets

As at 31st March 2019, Orbit's liquidity position, comprised of cash and cash equivalents and immediately available undrawn facilities was £126 million and £210 million respectively, for a total of £336 million liquid assets. This level of liquidity provides sufficient cover from FY2019 against the following two years of planned net capital spend (capex), at 1.6x. This is driven largely by the proceeds from Orbit's £450 million bond issuance, and represents a significant strengthening from Orbit's FY2018 liqiuidity cover position of 0.9x, which incorporated a front loaded capex and development programme. Liquidity cover remains strong at 1.2x of subsequent two years on planned net capex from FY2020, however this metric is set to weaken in FY2021 at beyond as the bond proceeds and other facilities are used to fund the group's strategy. Orbit's weakening ability to fully cover forthcoming planned capex will place downward pressure on the housing association's credit quality.

Orbit's ability to satisfy its funding requirements is supported by its strong unencumbered asset position, sufficient to support £916 million worth of additional borrowing, if required. This would easily cover planned borrowing for the next five years, while providing a buffer against potential mark-to-market calls on Orbit's standalone swap portfolio. Orbit's unencumbered asset position somewhat counterbalances the risks baked into the group's ambitious development plan to deliver approximately 8,700 units over the next five years.

Orbit's treasury policy is considered appropriate for its business plan. The treasury policy stipulates that Orbit should maintain sufficient cash to cover the next three months of forecast cash requirement, and sufficient cash and secured facilities to cover the next twelve months of forecast cash requirement. In addition, one of the housing association's internal "golden rules" requires cash and arranged unsecured loan facilities are to cover 24 months of the business plan's net cash requirement and uncommitted development spend.

Debt metrics forecast to remain relatively stable, despite planned borrowing increase

Orbit's debt has increased by compounded annual growth rate of 7.8% since FY2014 and is estimated to increase a further 12% in FY2019 to reach £1.3 billion, and steadily grow to reach £1.5 billion by FY2023, as Orbit plans to seek additional funding to support its growing development programme. At fiscal year end 2018, Orbit's outstanding debt equated to a gearing metric (debt to assets-at-cost) of 49%, which is in line with the rated peer median. Orbit's gearing metric has been stable since FY2016 and is set to align with A3-rated peers in FY2019. Similarly, Orbit's debt to revenues metric has historically been stable at 3.4x since FY2016 and remained at this level in FY2018, slightly stronger than the rated peer median of 3.8x. In FY2019, this metric is forecast to spike to 4.7x due in part to the gradual rise in debt stock, but mostly due to lower than forecasted sales revenues, generating an overall turnover of £308m, compared to a budgeted £356m. Orbit's business plan forecasts that debt to revenues will return to historical levels of around 3.4x by FY2021, however this will be reliant on achieving the levels of revenue outlined in the forecasts. The stability in Orbit's debt metrics are supported by the housing association's anticipated revenues and asset base growing in line with the increase in debt. We note however that increasing Orbit's debt position will challenge its credit quality, as relatively low debt had been a key factor in organisation's strong financial metrics.

Strong market position, simple structure, adept governance risk management

Orbit has been in operation for over 50 years, growing a portfolio which currently comprises of around 43,000 units focused predominantly in the Midlands, East England, and South East regions. Since 2013, Orbit have delivered an average of 1,700 new units and is planning to scale up its development plan to build 20,000 in ten years post-2020. Orbit is one of the UK's largest developers of social housing and has a strong presence within the markets it operates. As such, we find that Orbit is more able to carry influence in negotiations with other key market players and provide input to local and national policy. Moreover, Orbit's size reflects a large balance sheet that can better provide resilience to potential financial stresses, relative to smaller housing associations.

We find Orbit's governance structure to be straight forward and simple, consisting of two registered providers, Orbit South and Heart of England, tasked with the ownership and management of approximately 85% of the housing stock, and three unregistered entities responsible for specific roles. Orbit Capital Plc operates with the sole purpose of accessing capital markets for funding the group and its subsidiaries, Orbit Homes provides design and build services to support the group's development programme, and Orbit Treasury Limited provides treasury services to the registered providers.

Moreover, we considers Orbit to have financial, debt and investment management that is considered adept in enabling strong oversight and managing financial and operational risk through well-articulated policies and practices.

Ambitious development plan increasing capital expenditure and market sale exposure

Orbit plans to develop 8,700 new homes by FY2023, equating to a net capex of £725 million during this period. As such, in FY2019, planned net capex as a percentage of turnover remains high at 62% and is set to average 38% over the next four years. While the provision of general needs in Orbit's five year development programme will remain unchanged at 37%, the housing association aims to deliver a higher proportion of first tranche shared ownership units relative to last year, 32% from 27%. This is following new grant provision from Homes England of approximately £129 million to build more social housing. The shift in tenure splits has reduced the proportion of outright sales that Orbit plan to build over the next five years, to 20% from 23%. While we note that the planned development of outright sales has reduced, this has not been compensated by the provision of affordable housing, but rather by shared ownership development, which still carries a higher level of market risk than traditional social rented housing.

In FY2018, an estimated 37% of Orbit's revenues are expected to derive from market sales activities, and this is expected to rise over the medium term. The contribution of sales to turnover is set to increase to 44% by FY2021 and we consider this to be high exposure to the cyclical housing market. Significant sales programmes generally lead to more volatile cash flows, and inability to reach sales expectations could require additional debt to fund any potential financing gap in future years, potentially impacting debt metrics and interest cover ratios. Hence, Orbit's ability to manage the sales programme will be an important credit factor moving forward.

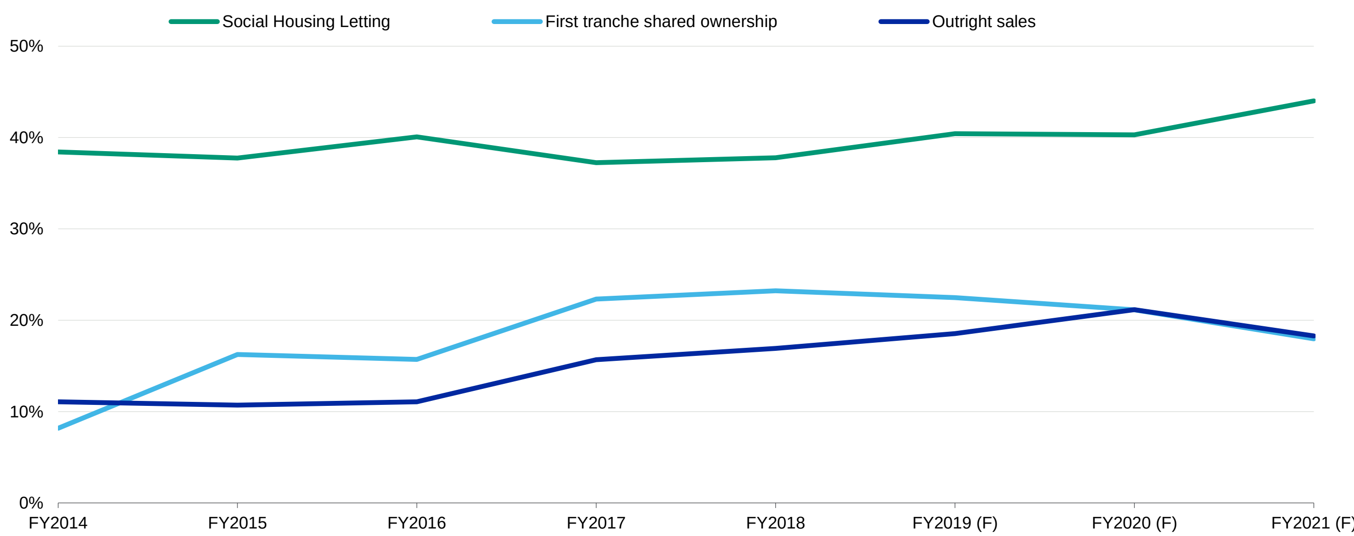
Supplementing its social housing and sales activities, Orbit has a significant asset disposals programme which is set to generate around £32 million in FY2019. The assets sales are part of a programme of stock rationalization and void sales, which are expected to continue and increase for the next few years. Proceeds from disposals will support total margins and serve to moderate net capex going forward.

Weaker operating margin than peers driven by lower margin sales activity

Since FY2015, Orbit has recorded lower operating margins than its rated peers. Margins currently are expected to be at 25%, compared to a 31% rated peer median. Orbit's operating margins are forecast to maintain at this level, averaging 27% over the next five years. The operating margins from Orbit's social housing letting business have historically been strong and are forecast to remain above 40%, however the operating margins from sales activity have dampened its overall performance as they tend to be lower and more volatile (Exhibit 3). As such, the group is set to see little improvement in its operating margin as its five year development programme comprises of 52% of units with market sales exposure.

Exhibit 4

Operating margins from social housing letting remain higher and more stable relative to sales



Source: Orbit and Moody's Investor Services

Exposure to capital market volatility as a result of standalone-swap portfolio

Orbit is exposed to capital market volatility as a result of its large portfolio of standalone swaps. As of March 2019, the portfolio stood at a notional amount of £329 million with a mark to market exposure of £106.8 million, up from £102.2 million May 2018. The group has a combination of cash and property collateral posted on the swap portfolio. Favourably, Orbit has a sizeable pool of assets that can be posted as collateral, as discussed in Orbit's credit strengths, which limits the liquidity risk associated with this exposure. Furthermore, Orbit's treasury policy requires them to stress test the negative impact of 50bps movements in interest rates, and to reserve aside enough security to cover this exposure.

Extraordinary support considerations

The strong level of extraordinary support factored into the rating reflects the wide-ranging powers of redress available to the regulator in cases of financial distress, with the possibility of a facilitated merger or a transfer of engagements. Recent history has shown that the UK government (Aa2 stable) is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support assumption also factors increasing exposure to non-core social housing activities in the sector, that add complexity to HA operations, and the weakening of the sovereign's financial resilience, making an extraordinary intervention slightly more challenging. In addition, our assessment that there is a very high default dependence between Orbit and the UK government reflects their strong financial and operational linkages.

Rating methodology and scorecard factors

Output of the Baseline Credit Assessment Scorecard

The assigned BCA of baa1 is aligned with the scorecard-suggested BCA.

Exhibit 5

Orbit Group

Baseline Credit Assessment Scorecard	Sub-factor Weighting	Value	Score
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	42,417	a
Factor 3: Financial Performance			
Operating Margin	5%	25.4%	a
Social Housing Letting Interest Coverage	10%	1.6x	a
Cash-Flow Volatility Interest Coverage	10%	2.1x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.4x	baa
Debt to Assets	10%	48.8%	ba
Liquidity Coverage	10%	1.1x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			**baa1**

Orbit Group 2018 BCA SCORECARD
Source: Moody's Investor Service, Orbit

The methodologies used in this rating are European Social Housing Providers, published in April 2018, and Government-Related Issuers, published in June 2018.

Ratings

Exhibit 6

Category	Moody's Rating
ORBIT GROUP LIMITED	
Outlook	Stable
Issuer Rating -Dom Curr	A3
ORBIT CAPITAL PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

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